No. ① 05 1318

Supreme Court, U.S.
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In The Supreme Court of the United States

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RUSSELL G. RUGGERIO,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

◆

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

◆

PETITION FOR WRIT OF CERTIORARI WITH APPENDIX

◆

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QUESTIONS PRESENTED

The United States Supreme Court has consistently upheld the primacy of state law in determining the nature of a taxpayer's interest in real property over laws passed by Congress. Maryland adheres to the doctrine of equitable conversion such that a contract purchaser becomes the equitable owner of real property under contract at the time of contract, while the seller holds only bare legal title and the right to receive the proceeds of sale.

The questions presented by this petition are:

1. Did the Fourth Circuit, contrary to this Court's precedents and in conflict with decisions of other circuits, err in applying federal and not state law to the question of whether a delinquent taxpayer had an ownership interest in real property under contract to a bona fide third party purchaser sufficient for federal tax liens to attach to that property?

2. Assuming that the appropriate initial inquiry is in fact federal and not state law, whether the Fourth Circuit erred in holding that a contract purchaser under a written executory contract to purchase real property is not a "purchaser" under § 6323 of the Internal Revenue Code?

RULE 14.1(b) STATEMENT

A list of all parties to the proceeding in the court whose judgment is the subject of this petition is as follows:

Petitioner/Appellee/Plaintiff below is Russell G. Ruggerio.

Respondent/Appellant/Defendant below is the Unites States of America.

There were no additional parties to the proceedings below.

RULE 29.6 STATEMENT

Petitioner Russell G. Ruggerio is an individual citizen of the United States of America. Mr. Ruggerio was the plaintiff in the United States District Court for the District of Maryland and the appellee before the United States Court of Appeals for the Fourth Circuit. This proceeding is being prosecuted on petitioner's behalf by Lawyers Title Insurance Corporation pursuant to an Owner's Policy of Title Insurance. Lawyers Title Insurance Corporation is a wholly owned subsidiary of Land America Financial Group, Inc., the shares of which are publicly traded on the New York Stock Exchange.

Respondent United States of America was the defendant in the District Court and the appellant before the United States Court of Appeals for the Fourth Circuit.

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PETITION FOR WRIT OF CERTIORARI

The Petitioner, Russell Ruggerio, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The opinion of the Fourth Circuit reversing the district court's opinion and order is unreported and is reproduced herein as Appendix A. (App. 1-7). The unreported decision of the United States District Court for the District of Maryland is reproduced herein as Appendix B. (App. 8-12). The Fourth Circuit's January 17, 2006 Order denying petitioner rehearing and rehearing *en banc* is reproduced as Appendix C. (App. 13).

JURISDICTION

The Fourth Circuit issued its opinion on November 17, 2005 and denied petitioner's requests for rehearing and rehearing *en banc* on January 17, 2005. This Court has jurisdiction to hear this petition pursuant to 28 U.S.C. § 1254(1).

RELEVANT STATUTORY PROVISIONS

Pursuant to Rule 14.1(f) of the Rules of the Supreme Court of the United States, all relevant statutory provisions are reproduced in their entirety in the appendix to this petition. A summary of the primarily relevant statutes follows:

Section 6321 of the Internal Revenue Code provides that if a taxpayer neglects or refuses to pay the tax after demand, the amount owed "shall be a lien *in favor of the United States* upon all property and rights to property, whether real or personal, belonging to such person."

Section 6323(a) of the Internal Revenue Code provides that liens imposed under § 6321 will not be valid against certain third parties, such as "purchasers," until the filing of notice.

Section 6323(h)(6) of the Internal Revenue Code defines "purchaser" as "a person who, for adequate and full consideration for money or money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice."

STATEMENT OF THE CASE

The Internal Revenue Code unquestionably establishes the ability of the federal government to impose liens on both the real and personal property of a taxpayer delinquent in the payment of federal taxes, and as well defines the priority and duration of such liens. In determining the nature and extent of the taxpayer's interest in the property to which the lien could attach, however, Congress and the courts defer to the law of the states.

This petition seeks review of a decision of the United States Court of Appeals for the Fourth Circuit, which erred by failing to apply Maryland law concerning the nature of a delinquent taxpayer's interest in real property. The opinion of the Fourth Circuit is in conflict with decisions of this Court holding that state law applies, and has created a split among the circuit courts of appeal. And regardless, even as to its own inquiry, the Fourth Circuit erred in its interpretation of § 6323 of the Internal Revenue Code.

FACTUAL BACKGROUND[1]

On January 14, 2003, Petitioner Russell G. Ruggerio entered into a written agreement of sale to purchase a condominium unit in Ocean City, Worcester County, Maryland from then-owner Rocky A. Kimbrew for $210,000.00. Unknown to petitioner, at that time Kimbrew was delinquent in the payment of federal payroll taxes for the period beginning September 30, 1998 and ending September 30, 2002.

On April 7, 2003, the United States filed two tax lien notices in the office of the Clerk of the Circuit Court for Worcester County assessing delinquent payroll taxes against Kimbrew in the aggregate amount of $143,163.27.

On April 8, 2003, petitioner performed as obligated under the terms of the contract by attending settlement and paying $45,304.11 of his own funds and $168,000.00 from the proceeds of a purchase money mortgage loan in exchange for a deed conveying legal title to the property to him, which deed was recorded among the land records for Worcester County one week later.[2] After enjoying his condominium for just nine months, petitioner received his first notice of the existence of the liens by letter dated January 27, 2004 from the United States. As a result of the threats contained in that letter, petitioner initiated a quiet title action in the United States District Court for the District of Maryland to determine the validity of the liens as against the property.

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[1] The facts set forth herein are taken from the opinions below, attached as Appendices A-B.

LOWER COURT PROCEEDINGS

After conducting discovery, petitioner filed a motion for summary judgment. In response, respondent filed a cross-motion for summary judgment together with its opposition to petitioner's motion. On January 31, 2005 the district court issued a memorandum opinion and order granting petitioner's motion for summary judgment and denying the cross-motion. (App. 8). According to the district court, the required initial inquiry is a determination of the delinquent taxpayer's interest in the property liened as defined by state law. The district court held that because Maryland recognizes the doctrine of equitable conversion, upon execution of the contract Kimbrew retained only bare legal title, while petitioner became equitable owner of the property. As such, when the United States recorded its tax liens on April 7, 2003, "Kimbrew's interest in the Property was limited to his anticipated proceeds from the sale. The tax liens did not attach to the Property but rather to Kimbrew's interest in the sale." (App. 11) (citing *SMS Associates v. Clay,* 868 F. Supp. 337, 344 (D.D.C. 1994), *aff'd,* 70 F.3d 638 (D.C. Cir. 1995)).

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[2] It is noteworthy that unknown to petitioner until the settlement, the property was heavily encumbered, and all of the sales proceeds were paid over to third parties.

On March 29, 2005, respondent noted its appeal to the Fourth Circuit.

Following oral argument, a panel of the Fourth Circuit issued an unpublished opinion reversing the district court. (App. 1). Instead of looking to Maryland law to establish the nature of Kimbrew's interest at the time the tax liens were recorded, the Fourth Circuit applied (and, as addressed *infra,* in fact misapplied) Congress' definition of "purchaser" in the Internal Revenue Code and determined that because petitioner did not fall within the IRC's definition of "purchaser" at the time the liens were recorded, the liens attached to the property. The Fourth Circuit misconstrued both the relevant interest and the applicable law, as the initial inquiry it should have undertaken was relative to the *delinquent taxpayer's interest* under Maryland law, not the *purchaser's interest* as defined by the Internal Revenue Code. The Fourth Circuit also erred in relying on *Bourke v. Krick,* 304 F.2d 501 (4th Cir. 1962), a decision that is inapposite to the situation at bar. Petitioner's request for rehearing and for rehearing *en banc* was denied on January 17, 2006. (App. 13). This petition followed.

REASONS FOR GRANTING THE PETITION

I. THE DECISION OF THE FOURTH CIRCUIT CONFLICTS WITH DECISIONS OF THIS COURT.

In reversing the well-reasoned opinion of the district court, the Fourth Circuit ignored long-standing precedents of this Court, which hold that the federal tax lien statute itself creates no property rights, but merely attaches consequences, federally defined, to rights created under state law. *See United States v. National Bank of Commerce,* 472 U.S. 713, 719 (1985); *Aquilino v. United States,* 363 U.S. 509, 513 (1960); *United States v. Bess,* 357 U.S. 51, 55 (1958); *Morgan v. Commissioner,* 309 U.S. 78, 82 (1940) ("in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property.")

This principle was acknowledged recently in *United States v. Craft,* 535 U.S. 274 (2002), in which in determining the existence, *vel non,* of property of a delinquent taxpayer which is subject to liens filed by the United States pursuant to 26 U.S.C. § 6321, the Court observed:

> A common idiom describes property as a 'bundle of sticks' – a collection of individual rights which, in certain combinations, constitute property. State law determines which sticks are in a person's bundle. Whether those sticks qualify as property for purposes of the

> federal tax lien statute is a question of federal law.

Craft, 535 U.S. at 278-79 (citations omitted); *see also Drye v. United States,* 528 U.S. 49, 58 (1999); *United States v. Rodgers,* 461 U.S. 677 (1983); *United States v. Brosnan,* 363 U.S. 237 (1960); *Hoornstra v. United States,* 969 F.2d 530 (7th Cir. 1992); *Prewitt v. United States,* 792 F.2d 1353 (5th Cir. 1986); *United States v. Stonehill,* 702 F.2d 1288 (9th Cir. 1983), *cert. denied,* 465 U.S. 1079 (1984); *United States v. Creamer Industries, Inc.,* 349 F.2d 625 (5th Cir.), *cert. denied,* 382 U.S. 957 (1965); and *In Re Halprin,* 280 F.2d 407 (3d Cir. 1960).

Craft confirmed that because the federal tax lien statute itself creates no property rights, courts must initially look to state law to determine what rights the taxpayer has in the property the federal government seeks to reach, and only then to federal law to determine whether such state-delineated rights qualify as "property" or "rights to property" under § 6321 of the Internal Revenue Code. *Craft,* 535 U.S. at 1420 (citing *Drye,* 528 U.S. at 58). The question that must first be addressed here, then, is what was Kimbrew's interest on April 7, 2003, as defined by Maryland law, and second, whether those rights qualify as "property" or "rights to property" under 26 U.S.C. § 6321?

It is undisputed that petitioner entered into a *bona fide* executory contract of sale to purchase real property from Kimbrew on January 14, 2003, and that at that time petitioner had no knowledge of any delinquent federal taxes owed by Kimbrew. It is also undisputed that petitioner fully performed under the contract by paying the full purchase price of $210,000.00 to acquire the property. The Fourth Circuit should have, but did not, look to state law to determine the "nature" of the interest in the real property owned by Kimbrew as of April 7, 2003, the date the tax liens were recorded.

Maryland recognizes the doctrine of equitable conversion. The Maryland Court of Appeals in *Himmighoefer v. Medallion Industries, Inc.*, 487 A.2d 282, 286 (Md. 1985), quoting from 8A Thompson, *Real Property* § 4447 (Grimes Repl. Vol. 1963), explained the doctrine of equitable conversion as follows:

> The legal cliché, that equity treats that as being done which should be done, is the basis of the theory of equitable conversion. Hence, when the vendee contracts to buy and the vendor to sell, though legal title has not yet passed, in equity the vendee becomes the owner of the land, the vendor of the purchase money. In equity the vendee has a real interest and the vendor a personal interest. Equity treats the executory contract as a conversion, whereby an equitable interest in the land is secured to the purchaser for whom the vendor holds the legal title in trust. This is the doctrine of equitable conversion.

(citation omitted).

Also well-stating Maryland law in this regard is the Maryland Court of Appeals' decision in *Stebbins-Anderson Co. v. Bolton,* 117 A.2d 908, 910 (Md. 1955) (citation omitted):

> The effect of such a contract is to vest the equitable ownership of the property in the vendee, subject to the vendor's lien for unpaid purchase money, and to leave only the legal title in the vendor pending the fulfillment of the contract and the formal conveyance of the estate. The right of the vendee to have the title conveyed upon full compliance with the contract of purchase is not impaired by the fact that the vendor, subsequently to the execution of the contract, incurred a debt upon which judgment was recovered. A judgment creditor 'stands in the place of his debtor, and he can only take the property of his debtor, subject to the equitable charges to which it was liable in the hands of the debtor, at the time of the rendition of the judgment.'

See also Coe v. Hays, 614 A.2d 576 (Md. 1992); *Watson v. Watson,* 497 A.2d 794 (Md. 1985); *White v. Simard,* 831 A.2d 517 (Md. App. 2003), *aff'd,* 859 A.2d 168 (Md. 2004).

On April 7, 2003, delinquent taxpayer Kimbrew's interest in the property was reduced to bare legal title and the right to receive the proceeds of sale.

At that time Kimbrew owned only a "personal interest" in the property, while under Maryland law petitioner owned the "real interest." *Himmighoefer*, 487 A.2d at 286. As of that date, the property rights traditionally associated with the ownership of real property were no longer in Kimbrew's "bundle of sticks" and consequently, the tax liens attached only to Kimbrew's interest in the proceeds of sale and not to the property itself. As this Court noted in *Drye*, "in determining whether a federal taxpayer's state-law rights constitute 'property' or 'rights to property,' '[t]he important consideration is the breadth of the control the [taxpayer] could exercise over the property'." *Drye*, 528 U.S. at 61 (quoting *Morgan v. Commissioner*, 309 U.S. 78, 83 (1940)). On April 7, 2003, Kimbrew could not exercise control over the property; he lost that largest of sticks when he signed the sales contract.

II. THE DECISION OF THE FOURTH CIRCUIT CREATES A SPLIT BETWEEN THE CIRCUITS.

Unlike the Fourth Circuit, the D.C. Circuit Court of Appeals recognized the appropriate inquiry and correctly applied the doctrine of equitable conversion under circumstances almost identical to those at bar. In fact, the impact of the doctrine of equitable conversion on the interest of a vendor of real estate pursuant to a contract of sale was precisely the issue in *SMS Associates v. Clay*, 868 F. Supp. 337 (D.D.C. 1994), *aff'd*, 70 F.3d 638 (D.C. Cir. 1995). Clay entered into a contract of sale on May 17, 1983 to convey certain real property lying in the District of Columbia to SMS Associates ("SMS"). The United States thereafter filed tax liens against Clay. Later, when Clay failed to perform under the contract of sale, SMS sued for specific performance and, by order of the Superior Court of the District of Columbia, Clay was divested of any legal and equitable title, right and interest in the real property in question. After entry of the order divesting Clay of title to the real property and vesting title in SMS, SMS filed a quiet title action against the United States and other judgment lien creditors asserting that neither the tax liens nor judgment liens encumbered the title to the real property conveyed to SMS.

In finding that the tax liens filed by the United States did not attach to the real property after the date of the contract of sale, the district court, relying upon *United States v. National Bank of Commerce, supra,* opined:

> the Supreme Court of the United States held that in determining what property or rights to property belong to the delinquent taxpayer, state law controls in determining the nature of the legal interest which the taxpayer has in the property. Since the District of Columbia adheres to the equitable conversion doctrine, the taxpayer . . . has the right to be paid for the property that he sold . . . . Thus, as the United States concludes, as of May 18, 1983, the date the contract to purchase the property was executed, . . . Clay's interest in the property was a right to payment of all remaining sums

> due from [SMS] under the contract. Accordingly, the tax liens have attached to [Clay's] right to be paid any outstanding sum due pursuant to the contract for the sale of the property.

SMS Associates v. Clay, 868 F. Supp. at 344. The district court then quieted title to the real property in SMS, free and clear of the federal tax lien filed by the United States, and concluded by ordering that:

> The tax liens filed by the United States . . . were all recorded after September 1, 1983 and are ineffective liens as against [the vendee's] interest in the property and therefore did not attach to the [real] property[.]

Id. at 345. It is particularly noteworthy that, unlike here, in *Clay* the United States properly conceded the priority of the contract purchaser's equitable interest over the federal tax liens.[3] The decision of the district court in *Clay* was affirmed, *per curium*. Although this decision was cited extensively in petitioner's brief, and referenced with approval in the Maryland district court's opinion and order, the Fourth Circuit's unpublished opinion did not address the conflict between its unique interpretation and the decision in SMS; instead, the Fourth Circuit erroneously predicated its opinion entirely on whether petitioner is "a purchaser" as defined in 26 U.S.C. § 2363(h)(6) and misapplied its own holding in *Bourke v. Krick,* 304 F.2d 501, 504 (4th Cir. 1962).

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[3] In footnote 10, the district court commented: "The United States concurs that [the vendee] has priority over the tax liens and therefore does not oppose an order quieting title to the property."

In contrast to the decisions in *United States v. National Bank of Commerce, Aquilino v. United States, United States v. Bess,* and *United States v. Rodgers,* the Fourth Circuit failed to recognize the nature of Kimbrew's interest in the real property as defined by Maryland law. Misunderstanding these principles, the Fourth Circuit held that the definition of "purchaser" (as defined in 26 U.S.C. § 6323(h)(6)) can be employed to defeat the "nature" of the property interest held by a delinquent taxpayer under state law, refusing to follow the Supreme Court's mandate to defer to the "nature" of Kimbrew's interest in the real property as defined by Maryland law. It was Kimbrew who was the delinquent taxpayer against whom the United States filed tax liens - not petitioner. It is the nature of the interest in the real property owned by the delinquent taxpayer at the time the tax liens were filed that should first be examined to determine whether or not the United States was entitled to a lien on the real property or whether the tax liens were converted to liens on the proceeds of sale. Here, equitable title transferred to petitioner *prior* to the tax liens being filed and, consequently, the tax liens attached only to the sale proceeds paid to Kimbrew. While the District of Columbia recognized this principle, the Fourth Circuit does not.

III. THE DECISION OF THE FOURTH CIRCUIT IGNORES OR MISAPPLIES IMPORTANT MARYLAND REAL PROPERTY LAW AND MISINTERPRETS AN IMPORTANT PROVISION OF THE INTERNAL REVENUE CODE.

Even assuming, *arguendo,* that whether petitioner is a "purchaser" under § 6323 is the appropriate initial inquiry, the Fourth Circuit erred in failing to qualify petitioner as such.

Although generally federal tax liens are valid against the world, § 6323(a) carves out exceptions for priority treatment for four classes of interests. One such excepted class is for "purchasers," who enjoy priority over tax liens if the "purchase" is completed before the filing of the liens. A "purchaser" is defined in § 6323(a) broadly to include any person who acquires an interest (other than a lien or security interest) in property that is superior, under local law, as against subsequent purchasers without actual notice for consideration. By virtue of § 6323(h)(6)(B), a "purchaser" includes a person who has entered into "a written executory contract to purchase or lease property." 26 U.S.C. 6323(h)(6)(B); *see also Rodeck v. United States,* 697 F. Supp. 1508 (D. Minn. 1988) (transferee who accepted vendor's interest in contract deed in exchange for the taxpayer-vendor's release from a child support payment obligation was a "purchaser.")

Consistent with this definition is Senate Report No. 1708, 89th Cong., 2d Sess. 3 (1966), reprinted in 1966 USCCAN 3722, 3734-5, wherein the Senate reported that IRC § 6323(h)(6):

> adds a definition of 'purchaser,' a term which appears in present law but is not defined for purposes of the provisions relating to tax liens. A purchaser is defined as a person who, for adequate and full consideration in money or money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law as against subsequent purchasers without actual notice. By requiring 'adequate and full consideration,' the bill modifies the results reached in court decisions under present law in that the amount paid can no longer be so small as to have little relation to the value of the property acquired. However, this requirement is not intended to preclude a bona fide bargain purchaser or a purchaser who has not completed performance of his obligation, such as the completion of his installment payments. **The term 'purchaser' as used here includes one who has acquired a lease of property, *an executory contract to purchase or lease property,* one who has an option to purchase or lease property or an interest in it, or one who has an option to renew or extend a**

> **lease on property if the interest acquired is not a lien or a security interest.** Thus, for example, the holder of an option is not to lose the right to acquire the property at the option price.

(Emphasis added) (App. 66). The Ninth Circuit has recognized this definition as well. In *Newnham v. United States*, 813 F.2d 1384 (9th Cir. 1987), the Treasury Department attempted to best the interests of a purchaser under an executory contract to purchase following default by the seller. The seller had defaulted prior to close of escrow, after which the buyer sued for specific performance. Thereafter, the United Stated recorded its tax liens. The Ninth Circuit rejected the United States' argument that the default prevented the buyer from obtaining "purchaser" status, holding that she was a "purchaser" by *virtue of her written executory contract. Id.* at 1385.

The Fourth Circuit misapplied its own decision in *Bourke v. Krick*, 304 F.2d 501, 504 (4th Cir. 1962) to support the proposition that "legal title to land does not pass until a deed is properly executed and recorded, and a vendee's equity in property is subject to destruction of the legal title to a bona fide purchaser without notice." (App. 6) (emphasis omitted). *Bourke,* which was written prior to Maryland's own leading equitable conversion cases, merely affirms the concept that the equitable title of a purchaser under the provisions of an executory contract of sale may be destroyed by an unscrupulous seller who executes and delivers a deed to a subsequent bona fide purchaser for value without notice of the existence of the prior executory contract. Consequently, *Bourke* held that "legal title to land does not pass until a deed is properly executed and recorded." In the case *sub judice,* the facts do not involve the destruction of the equitable title of a purchaser under an executory contract, which was the principal addressed in *Bourke* and upon which the Fourth Circuit relied in reversing the district court here. To the contrary, the case at hand concerns the nature of the "sticks" owned by Kimbrew after he entered into the executory contract on January 14, 2003. Under Maryland law, the only vestage of ownership remaining in Kimbrew on April 7, 2003 was the contractual right to receive the proceeds of sale.

Moreover, in the decision in *Bourke,* the Fourth Circuit (citing *Kinsey v. Drury,* 126 A. 125 (Md. 1924) and *Aames & Sons v. Roderick,* 98 A. 42 (Md. 1916), was aware that:

> Maryland decisions giving a preference to a vendee under a contract of sale over subsequent attacking creditors of the vendor do not conflict with the view we take. Such cases rest on equitable principles not here relevant, for no one here is contesting the church's right to the land upon payment of the purchase price.

Simply stated, *Bourke* was not concerned with the property interest retained by a vendor under an executory contract of sale but, instead, addressed whether or not that same vendor could execute a valid recordable deed conveying legal title to a party other than the vendee under the executory contract.

Maryland law is clear that prior contracts for the sale of real property have priority over subsequent contracts. *Cherry v. Stein*, 11 Md. 1 (1858). The obvious reason for this rule rests on concepts of equitable conversion discussed above; that is, equitable title conveys to a purchaser at the time of execution of a contract of sale. The seller retains only bare legal title pending receipt of the purchase price. So even under the Fourth Circuit's erroneous initial inquiry, petitioner should have prevailed.

CONCLUSION

For all of the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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Dated: April 14, 2006

APPENDIX
A – H

UNPUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 05-1387

[ENTERED November 17, 2005]

RUSSELL G. RUGGERIO,

Plaintiff - Appellee,

Versus

UNITED STATES OF AMERICA,

Defendant - Appellant.

Appeal from the United States District Court for the District of Maryland, at Baltimore. William D. Quarles, Jr., District Judge. (CA-04-639-WDQ)

Argued: October 25, 2005

Decided: November 17, 2005

Before MOTZ, TRAXLER, and SHEDD, Circuit Judges.

Reversed and remanded by unpublished opinion. Judge Shedd wrote the opinion, in which Judge Motz and Judge Traxler joined.

ARGUED: Bethany Buck Hauser, UNITED STATES DEPARTMENT OF JUSTICE, Tax Division, Washington, D.C., for Appellant. Griffin Vann Canada, Jr., MILES & STOCKBRIDGE, Rockville, Maryland, for Appellee. **ON BRIEF:** Eileen J. O'Connor, Assistant Attorney General, Frank P. Cihlar, Tax Division, Allen Loucks, United States Attorney, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellant. Rachel T. McGuckian, MILES & STOCKBRIDGE, Rockville, Maryland, for Appellee.

Unpublished opinions are not binding precedent in this circuit. See Local Rule 36(c).

SHEDD, Circuit Judge:

Russell G. Ruggerio brought this action against the United States to quiet title to a condominium ("the Property") in Worcester County, Maryland. Specifically, Ruggerio sought a declaration that the Property was not encumbered by federal tax liens assessed against Rocky A. Kimbrew, the prior owner of the Property. After both parties moved for summary judgment, the district court granted Ruggerio's motion based on the doctrine of equitable conversion. The United States now appeals. For the reasons set forth below, we reverse and remand for further proceedings consistent with this opinion.

I.

We review de novo a district court's award of summary judgment, viewing the facts and inferences drawn therefrom in the light most favorable to the non-moving party. Scott v. United States, 328 F.3d 132, 137 (4th Cir. 2003). An award of summary judgment is appropriate only "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c).

Between 1998 and 2002, the Commissioner of Internal Revenue ("the Commissioner") assessed payroll taxes of $143,000 against Kimbrew, a delinquent taxpayer. On January 14, 2003, Kimbrew entered into a contract to sell the Property to Ruggerio. At the time of contracting, Ruggerio had no knowledge of Kimbrew's tax delinquency.

On April 7, 2003, the Commissioner filed notices of federal tax liens against Kimbrew in Worcester County. The next day, Kimbrew executed and delivered the deed to the Property to Ruggerio in exchange for approximately $210,000. Ruggerio filed the deed with Worcester County land records several days later.

The Commissioner then demanded that Ruggerio pay the government for release of the federal tax liens. Ruggerio brought this suit to quiet title, arguing that because he signed the contract of purchase before the Commissioner filed the notices of federal tax liens, the Property was not encumbered by those liens. On cross-motions for summary judgment, the district court granted summary judgment in favor of Ruggerio on the basis of equitable conversion and denied the United States' motion. The district court concluded that, because Kimbrew's interest in the Property after contracting was limited to his anticipated proceeds from the sale, the tax liens did not attach to the Property but rather to Kimbrew's interest in the sales proceeds. Thus, the district court held that the Commissioner could not enforce the federal tax liens against Ruggerio.

II.

Section 6321 of the Internal Revenue Code ("IRC") provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." 26 U.S.C. § 6321. Further, "the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied." Id. at § 6322. "For the lien to become valid and effective under these sections, notice, filing or recording are not required." United States v. Bond, 279 F.2d 837, 841 (4th Cir. 1960). Therefore, because federal tax liens attach at the time the assessment is made, the liens attached to the Property by 2002, before Kimbrew and Ruggerio entered into their contract.

However, § 6323 of the IRC provides that liens imposed under § 6321 will not be valid against certain third parties, such as "purchasers," until the filing of notice. 26 U.S.C. § 6323(a); see also United States v.

Gold, 178 F.3d 718, 721 (4th Cir. 1999) ("Liens created by § 6321 become 'valid' as against third parties upon the IRS's filing notice of the lien in any recording office within the state in which the property is located."). The IRC defines "purchaser" as "a person who, for adequate and full consideration in money or money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice." 26 U.S.C. § 6323(h)(6) (emphasis added). Ruggerio argues that because of his prior contract with Kimbrew, he became a "purchaser" under § 6323 before April 7, 2003, the date the Commissioner filed notices of federal tax liens. Specifically, Ruggerio contends that upon contracting he possessed equitable title to the Property and Kimbrew possessed only legal title under the doctrine of equitable conversion. See Watson v. Watson, 497 A.2d 794, 800 (Md. 1985).

Ruggerio's status as a "purchaser" under the IRC turns on whether his interest was valid against subsequent purchasers without actual notice under Maryland law before April 7, 2003. The Maryland recording statute provides that:

> Every recorded deed or other instrument takes effect from its effective date as against the grantee of any deed executed and delivered subsequent to the effective date, unless the grantee of the subsequent deed has:
>
> (1) Accepted delivery of the deed or other instrument:

(i) In good faith;

(ii) Without constructive notice under § 3-202; and

(iii) For a good and valuable consideration; and

(2) Recorded the deed first.

Md. Code Ann., Real Prop. § 3-203 (2005) (emphasis added). We have noted that "the Maryland law is that legal title to land does not pass until a deed is properly executed and recorded, and . . . until this is done a vendee's equity in property is subject to destruction by a conveyance of the legal title to a bona fide purchaser without notice." Bourke v. Krick, 304 F.2d 501, 504 (4th Cir. 1962) (emphasis added). Hence, under Maryland law Ruggerio's interest in the Property would be invalid against subsequent purchasers without actual notice. See Price v. McDonald, 1 Md. 403, 414-15 (1851) (stating that "an equitable claim . . . will be enforced in a court of equity, except against a bona fide purchaser without notice"). Because Ruggerio's interest in the Property was subject to destruction under Maryland law by subsequent purchasers without actual notice, he did not qualify as a "purchaser" under § 6323(h) of the IRC before April 7, 2003. Thus, the federal tax liens on the Property remain valid against Ruggerio.*

---

*To the extent that Ruggerio may have achieved "purchaser" status after April 7, 2003, the federal tax liens on the Property remain valid against him based on the antecedent filing of tax notices. 26 U.S.C. § 6323(a); see also Gold, 178 F.3d at 721("Liens created by § 6321 become

III.

Accordingly, we reverse the district court's order granting summary judgment in favor of Ruggerio and remand this case for further proceedings consistent with this opinion.

REVERSED AND REMANDED

'valid' as against third parties upon the IRS's filing notice of the lien in any recording office within the state in which the property is located.").

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND, NORTHERN DIVISION

RUSSELL G. RUGGERIO

Plaintiff,

v.

CIVIL NO.: WDQ-04-639

UNITED STATES OF AMERICA

Defendant.

[ENTERED March 4, 2004]

MEMORANDUM OPINION AND ORDER

Citing 28 U.S.C. § 1340, Russell G. Ruggerio brought an action against the United States of America to quiet title. Pending are Ruggerio's motion for summary judgment and the United States' cross motion for summary judgment. For the following reasons, Ruggerio's motion for summary judgment will be granted, and the United States' cross motion for summary judgment will be denied.

I. BACKGROUND

On January 14, 2003, Ruggerio and Rocky A. Kimbrew entered into a contract of sale for real property in Ocean City, Maryland (the "Property"). On

April 7, 2003, the day before settlement, the Department of Treasury filed two federal tax liens against Kimbrew. On January 27, 2004, the Department of Treasury informed Ruggerio that in satisfaction of Kimbrew's liens the Property would be seized. Ruggerio alleges that these liens are neither valid nor enforceable. On March 24, 2004, Ruggerio filed this action.

II. LEGAL DISCUSSION

A. Motion for Summary Judgment

1. Standard of Review

Summary judgment is appropriate when there is no genuine issue of any material fact, and the moving party is entitled to judgment as a matter of law. In *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986), the Supreme Court explained that, in considering a motion for summary judgment, "the judge's function is not . . . to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." A dispute about a material fact is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id.* at 248. Thus, "the judge must ask . . . whether a fair-minded jury could return a verdict for the [nonmoving party] on the evidence presented."
Id. at 252.

The court must view the facts and the reasonable inferences drawn therefrom "in the light most favorable to the party opposing the motion," *Matsushita Electric Industrial Company v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986), but the opponent must produce evidence upon which a reasonable fact finder could rely. *Celotex Corp. v. Catrett,* 477 U.S. 317 (1986). The mere existence of a "scintilla" of evidence is not sufficient to preclude summary judgment. *Anderson,* 477 U.S. at 252.

2. Waiver of Sovereign Immunity

The United States may not be sued without its consent; consent is a prerequisite for jurisdiction. *Randall v. United States of America,* 95 F.3d 339,345 (4th Cir. 1996) (*quoting United States v. Mitchell,* 463 U.S. 206, 212 (1983)). A waiver of the traditional sovereign immunity cannot be implied but must be unequivocally expressed. *United States v. Testan,* 424 U.S. 392, 399 (1976) (*quoting United States v. King,* 395 U.S. 1, 4 (1969)). Title 28 of the U.S. Code, § 2410(a) waives the Government's sovereign immunity in quiet title actions. The United States contends that this Court lacks jurisdiction because Ruggerio failed to plead waiver of sovereign immunity.

Ruggerio brings this action solely under 28 U.S.C. § 1340, a general jurisdictional statute which is not a waiver of sovereign immunity. *See Randall,* 95 F.3d at 345. Although Ruggerio failed to plead 28 U.S.C. § 2410(a), the Court has examined the complaint and determined that the allegations support jurisdiction. *See Randall,* 95 F.3d at 345 ("all pleadings shall be construed as to do substantial justice"). In quiet title actions, the complaint must include the name and address of the delinquent taxpayer, the identity of the internal revenue office filing the lien notice and the date and place of filing. *See* 28 U.S.C. § 2410 (b). As Ruggerio has complied with these requirements, the Court has jurisdiction.

3. Whether Ruggerio's property is subject to the tax liens

The United States may impose a lien upon a delinquent tax payer's real or personal property. *See* 26 U.S.C. § 6321. State law controls in determining the nature of the legal interest which the taxpayer had in the property. *United States v. National Bank of Commerce,* 472 U.S. 713, 722 (1985). Maryland recognizes the doctrine of equitable conversion. Upon execution of a contract of sale, the purchaser becomes the equitable owner of the property and the seller retains bare legal title. *See Watson v. Watson,* 304 Md. 48, 60 (1985). Thereafter, the seller's property interests are limited to the proceeds of the sale. *See id.*

When the Defendant filed the tax liens, Kimbrew's interest in the Property was limited to his anticipated proceeds from the sale. The tax liens did not attach to the Property but rather to Kimbrew's interest in the proceeds of the sale. *See SMS Associates v. Clay,* 868 F.Supp. 337, 344 (D.D.C. 1994). The United States contends that the liens attached to the Property because the liens had priority over Ruggerio's interests under 26 U.S.C. § 6323. Section 6323 governs the validity and priority of liens imposed against a taxpayer's property. *See* 26 U.S.C. § 6323. This section merely established the priority of the Government's liens against the sale proceeds. *See National Bank of*

Commerce, 472 U.S. at 722 ("revenue statutes do not create property rights but merely attaches federally defined consequences to rights created under state law"). Accordingly, the plaintiff's motion for summary judgment will be granted.

III. CONCLUSION

For the reasons discussed above, Ruggerio's motion for summary judgment will be granted and the United States' cross motion for summary judgment will be denied.

1/31/2005 /s/
Date William D. Quarles, Jr.
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

FILED
January 17, 2006

No. 05-1387
CA-04-639-WDQ

[ENTERED January 17, 2006]

RUSSELL G. RUGGERIO

Plaintiff - Appellee

v.

UNITED STATES OF AMERICA

Defendant - Appellant

On Petition for Rehearing and Rehearing En Banc

The appellee's petition for rehearing and rehearing en banc was submitted to this Court. As no member of this Court or the panel requested a poll on the petition for rehearing en banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and rehearing en banc is denied.

Entered for a panel composed of Judge Motz, Judge Traxler, and Judge Shedd.

For the Court,

/s/ Patricia S. Connor

CLERK

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

FILED
January 25, 2006

No. 05-1387
CA-04-639-WDQ

[ENTERED January 25, 2006]

RUSSELL G. RUGGERIO

Plaintiff - Appellee

v.

UNITED STATES OF AMERICA

Defendant – Appellant

MANDATE

The judgment of this Court, entered 11/17/05, takes effect this date.

A certified copy of this Court's judgment and a copy of its decision are issued herewith and constitute the mandate of this Court.

/s/ Patricia S. Connor
CLERK

TITLE 26. INTERNAL REVENUE CODE
SUBTITLE F. PROCEDURE AND ADMINISTRATION
CHAPTER 64. COLLECTION
SUBCHAPTER C. LIEN FOR TAXES
PART II. LIENS

26 USCS § 6321

§ 6321. Lien for taxes.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

HISTORY:

(Aug. 16, 1954, ch 736, 68A Stat. 779.)

TITLE 26. INTERNAL REVENUE CODE
SUBTITLE F. PROCEDURE AND ADMINISTRATION
CHAPTER 64. COLLECTION
SUBCHAPTER C. LIEN FOR TAXES
PART II. LIENS

26 USCS § 6322

§ 6322. Period of lien.

Unless another date is specifically fixed by law, the lien imposed by section 6321 [26 USCS § 6321] shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time.

HISTORY:

(Aug. 16, 1954, ch 736, 68A Stat. 779; Nov. 2, 1966, P.L. 89-719, Title I, § 113(a), 80 Stat. 1146.)

TITLE 26. INTERNAL REVENUE CODE
SUBTITLE F. PROCEDURE AND ADMINISTRATION
CHAPTER 64. COLLECTION
SUBCHAPTER C. LIEN FOR TAXES
PART II. LIENS

26 USCS § 6323

§ 6323. Validity and priority against certain persons.

(a) Purchasers, holders of security interests, mechanic's lienors, and judgment lien creditors. The lien imposed by section 6321 [26 USCS § 6321] shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary.

(b) Protection for certain interests even though notice filed. Even though notice of a lien imposed by section 6321 [26 USCS § 6321] has been filed, such lien shall not be valid—

(1) Securities. With respect to a security (as defined in subsection (h)(4))—

(A) as against a purchaser of such security who at the time of purchase did not have actual notice or knowledge of the existence of such lien; and

(B) as against a holder of a security interest in such security who, at the time such interest came into existence, did not have actual notice or knowledge of the existence of such lien.

(2) Motor vehicles. With respect to a motor vehicle (as defined in subsection (h)(3)), as against a purchaser of such motor vehicle, if—

(A) at the time of the purchase such purchaser did not have actual notice or knowledge of the existence of such lien, and

(B) before the purchaser obtains such notice or knowledge, he has acquired possession of such motor vehicle and has not thereafter relinquished possession of such motor vehicle to the seller or his agent.

(3) Personal property purchased at retail. With respect to tangible personal property purchased at retail, as against a purchaser in the ordinary course of the seller's trade or business, unless at the time of such purchase such purchaser intends such purchase to (or knows such purchase will) hinder, evade, or defeat the collection of any tax under this title.

(4) Personal property purchased in casual sale [Caution: See § 3.33 of Rev. Proc. 2005-70 (26 USCS § 1 note) for provision that, for calendar year 2006, a federal tax lien is not valid against certain purchasers under this paragraph that purchased personal property in a casual sale for less than $ 1,240.]. With respect to household goods, personal effects, or other tangible personal property described in section 6334(a) [26 USCS § 6334(a)] purchased (not for resale) in a casual sale for less than $ 1,000, as against the

purchaser, but only if such purchaser does not have actual notice or knowledge (A) of the existence of such lien, or (B) that this sale is one of a series of sales.

(5) Personal property subject to possessory lien. With respect to tangible personal property subject to a lien under local law securing the reasonable price of the repair or improvement of such property, as against a holder of such a lien, if such holder is, and has been, continuously in possession of such property from the time such lien arose.

(6) Real property tax and special assessment liens. With respect to real property, as against a holder of a lien upon such property, if such lien is entitled under local law to priority over security interests in such property which are prior in time, and such lien secures payment of—

(A) a tax of general application levied by any taxing authority based upon the value of such property;

(B) a special assessment imposed directly upon such property by any taxing authority, if such assessment is imposed for the purpose of defraying the cost of any public improvement; or

(C) charges for utilities or public services furnished to such property by the United States, a State or political subdivision thereof, or an instrumentality of any one or more of the foregoing.

(7) Residential property subject to a mechanic's lien for certain repairs and improvements [Caution: See § 3.33 of Rev. Proc. 2005-70 (26 USCS § 1 note) for provision that, for calendar year 2006, a federal tax lien is not valid against a mechanic's lienor under this paragraph that repaired or improved certain residential property if the contract price with the owner is not more than $ 6,210.]. With respect to real property subject to a lien for repair or improvement of a personal residence (containing not more than four dwelling units) occupied by the owner of such residence, as against a mechanic's lienor, but only if the contract price on the contract with the owner is not more than $ 5,000.

(8) Attorneys' liens. With respect to a judgment or other amount in settlement of a claim or of a cause of action, as against an attorney who, under local law, holds a lien upon or a contract enforcible against such judgment or amount, to the extent of his reasonable compensation for obtaining such judgment or procuring such settlement, except that this paragraph shall not apply to any judgment or amount in settlement of a claim or of a cause of action against the United States to the extent that the United States offsets such judgment or amount against any liability of the taxpayer to the United States.

(9) Certain insurance contracts. With respect to a life insurance, endowment, or annuity contract, as against the organization which is the insurer under such contract, at any time—

(A) before such organization had actual notice or knowledge of the existence of such lien;

(B) after such organization had such notice or knowledge, with respect to advances required to be made automatically to maintain such contract in force under an agreement entered into before such organization had such notice or knowledge; or

(C) after satisfaction of a levy pursuant to section 6332(b) [26 USCS § 6332(b)], unless and until the Secretary delivers to such organization a notice, executed after the date of such satisfaction, of the existence of such lien.

(10) Deposit-secured loans. With respect to a savings deposit, share, or other account with an institution described in section 581 or 591 [26 USCS § 581 or 591], to the extent of any loan made by such institution without actual notice or knowledge of the existence of such lien, as against such institution, if such loan is secured by such account.

(c) Protection for certain commercial transactions financing agreements, etc.

(1) In general. To the extent provided in this subsection, even though notice of a lien imposed by section 6321 [26 USCS § 6321] has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing but which--

(A) is in qualified property covered by the terms of a written agreement entered into before tax lien filing and constituting—

(i) a commercial transactions financing agreement,

(ii) a real property construction or improvement financing agreement, or

(iii) an obligatory disbursement agreement, and

(B) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation.

(2) Commercial transactions financing agreement. For purposes of this subsection—

(A) Definition. The term "commercial transactions financing agreement" means an agreement (entered into by a person in the course of his trade or business)-

(i) to make loans to the taxpayer to be secured by commercial financing security acquired by the taxpayer in the ordinary course of his trade or business, or

(ii) to purchase commercial financing security (other than inventory) acquired by the taxpayer in the ordinary course of his trade or business;

but such an agreement shall be treated as coming within the term only to the extent that such loan or purchase is made before the 46th day after the date of tax lien filing or (if earlier) before the lender or purchaser had actual notice or knowledge of such tax lien filing.

(B) Limitation on Qualified Property. The term "qualified property", when used with respect to a commercial transactions financing agreement, includes only commercial financing security acquired by the taxpayer before the 46th day after the date of tax lien filing.

(C) Commercial Financing Security Defined. The term "commercial financing security" means (i) paper of a kind ordinarily arising in commercial transactions, (ii) accounts receivable, (iii) mortgages on real property, and (iv) inventory.

(D) Purchaser Treated as Acquiring Security Interest. A person who satisfies subparagraph (A) by reason of clause (ii) thereof shall be treated as having acquired a security interest in commercial financing security.

(3) Real property construction or improvement financing agreement. For purposes of this subsection--

(A) Definition. The term "real property construction or improvement financing agreement" means an agreement to make cash disbursements to finance--

(i) the construction or improvement of real property,

(ii) a contract to construct or improve real property, or

(iii) the raising or harvesting of a farm crop or the raising of livestock or other animals. For purposes of clause (iii), the furnishing of goods and services shall be treated as the disbursement of cash.

(B) Limitation on qualified property. The term "qualified property", when used with respect to a real property construction or improvement financing agreement, includes only—

(i) in the case of subparagraph (A)(i), the real property with respect to which the construction or improvement has been or is to be made,

(ii) in the case of subparagraph (A)(ii), the proceeds of the contract described therein, and

(iii) in the case of subparagraph (A)(iii), property subject to the lien imposed by section 6321 [26 USCS § 6321] at the time of tax lien filing and the crop or the livestock or other animals referred to in subparagraph (A)(iii).

(4) Obligatory disbursement agreement. For purposes of this subsection—

(A) Definition. The term "obligatory disbursement agreement" means an agreement (entered into by a person in the course of his trade or business) to make disbursements, but such an agreement shall be treated as coming within the term only to the extent of disbursements which are required to be made by reason of the intervention of the rights of a person other than the taxpayer.

(B) Limitation on qualified property. The term "qualified property", when used with respect to an obligatory disbursement agreement, means property subject to the lien imposed by section 6321 [26 USCS § 6321] at the time of tax lien filing and (to the extent that the acquisition is directly traceable to the disbursements referred to in subparagraph (A)) property acquired by the taxpayer after tax lien filing.

(C) Special rules for surety agreements. Where the obligatory disbursement agreement is an agreement ensuring the performance of a contract between the taxpayer and another person—

(i) the term "qualified property" shall be treated as also including the proceeds of the contract the performance of which was ensured, and

(ii) If the contract the performance of which was ensured was a contract to construct or improve real property, to produce goods, or to furnish services, the term "qualified property" shall be treated as also including any tangible personal property used by the taxpayer in the performance of such ensured contract.

(d) 45-day period for making disbursements. Even though notice of a lien imposed by section 6321 [26

USCS § 6321] has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing by reason of disbursements made before the 46th day after the date of tax lien filing, or (if earlier) before the person making such disbursements had actual notice or knowledge of tax lien filing, but only if such security interest—

(1) is in property (A) subject, at the time of tax lien filing, to the lien imposed by section 6321 [26 USCS § 6321], and (B) covered by the terms of a written agreement entered into before tax lien filing, and

(2) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation.

(e) Priority of interest and expenses. If the lien imposed by section 6321 [26 USCS § 6321] is not valid as against a lien or security interest, the priority of such lien or security interest shall extend to—

(1) any interest or carrying charges upon the obligation secured,

(2) the reasonable charges and expenses of an indenture trustee or agent holding the security interest for the benefit of the holder of the security interest,

(3) the reasonable expenses, including reasonable compensation for attorneys, actually incurred in collecting or enforcing the obligation secured,

(4) the reasonable costs of insuring, preserving, or repairing the property to which the lien or security interest relates,

(5) the reasonable costs of insuring payment of the obligation secured, and

(6) amounts paid to satisfy any lien on the property to which the lien or security interest relates, but only if the lien so satisfied is entitled to priority over the lien imposed by section 6321 [26 USCS § 6321],

to the extent that, under local law, any such item has the same priority as the lien or security interest to which it relates.

(f) Place for filing notice; form.

(1) Place for filing. The notice referred to in subsection (a) shall be filed –

(A) Under state laws.

(i) Real property. In the case of real property, in one office within the State (or the county, or other governmental subdivision), as designated by the laws of such State, in which the property subject to the lien is situated; and

(ii) Personal property. In the case of personal property, whether tangible or intangible, in one office within the State (or the county, or other governmental subdivision), as designated by the laws of such State, in which the property subject to the lien is situated, except that State law merely conforming to or reenacting Federal law establishing a national filing system does not constitute a second office for filing as designated by the laws of such State; or

(B) With clerk of district court. In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State has not by law designated one office which meets the requirements of subparagraph (A); or

(C) With recorder of deeds of the District of Columbia. In the office of the Recorder of Deeds of the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(2) Situs of property subject to lien. For purposes of paragraphs (1) and (4), property shall be deemed to be situated--

(A) Real property. In the case of real property, at its physical location; or

(B) Personal property. In the case of personal property, whether tangible or intangible, at the residence of the taxpayer at the time the notice of lien is filed.

For purposes of paragraph (2)(B), the residence of a corporation or partnership shall be deemed to be the place at which the principal executive office of the business is located, and the residence of a taxpayer whose residence is without the United States shall be deemed to be in the District of Columbia.

(3) Form. The form and content of the notice referred to in subsection (a) shall be prescribed by the Secretary. Such notice shall be valid notwithstanding any other provision of law regarding the form or content of a notice of lien.

(4) Indexing required with respect to certain real property. In the case of real property, if—

(A) under the laws of the State in which the real property is located, a deed is not valid as against a purchaser of the property who (at the time of purchase) does not have actual notice or knowledge of the existence of such deed unless the fact of filing of such deed has been entered and recorded in a public index at the place of filing in such a manner that a reasonable inspection of the index will reveal the existence of the deed, and

(B) there is maintained (at the applicable office under paragraph (1)) an adequate system for the public indexing of Federal tax liens,

then the notice of lien referred to in subsection (a) shall not be treated as meeting the filing requirements under paragraph (1) unless the fact of filing is entered and recorded in the index referred to in subparagraph (B) in such a manner that a reasonable inspection of the index will reveal the existence of the lien.

(5) National filing systems. The filing of a notice of lien shall be governed solely by this title and shall not be subject to any other Federal law establishing a place or places for the filing of liens or encumbrances under a national filing system.

(g) Refiling of notice. For purposes of this section –

(1) General rule. Unless notice of lien is refiled in the manner prescribed in paragraph (2) during the required refiling period, such notice of lien shall be treated as filed on the date on which it is filed (in accordance with subsection (f)) after the expiration of such refiling period.

(2) Place for filing. A notice of lien refiled during the required refiling period shall be effective only –

(A) if –

(i) such notice of lien is refiled in the office in which the prior notice of lien was filed, and

(ii) in the case of real property, the fact of refiling is entered and recorded in an index to the extent required by subsection (f)(4); and

(B) in any case in which, 90 days or more prior to the date of a refiling of notice of lien under subparagraph (A), the Secretary received written information (in the manner prescribed in regulations issued by the Secretary) concerning a change in the taxpayer's residence, if a notice of such lien is also filed in accordance with subsection (f) in the State in which such residence is located.

(3) Required refiling period. In the case of any notice of lien, the term "required refiling period" means--

(A) the one-year period ending 30 days after the expiration of 10 years after the date of the assessment of the tax, and

(B) the one-year period ending with the expiration of 10 years after the close of the preceding required refiling period for such notice of lien.

(4) Transitional rule. Notwithstanding paragraph (3), if the assessment of the tax was made before January 1, 1962, the first required refiling period shall be the calendar year 1967.

(h) Definitions. For purposes of this section and section 6324 [26 USCS § 6324] –

(1) Security interest. The term "security interest" means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth.

(2) Mechanic's lienor. The term "mechanic's lienor" means any person who under local law has a lien on real property (or on the proceeds of a contract relating to real property) for services, labor, or materials furnished in connection with the construction or improvement of such property. For purposes of the preceding sentence, a person has a lien on the earliest date such lien becomes valid under local law against subsequent purchasers without actual notice, but not before he begins to furnish the services, labor, or materials.

(3) Motor vehicle. The term "motor vehicle" means a self-propelled vehicle which is registered for highway use under the laws of any State or foreign country.

(4) Security. The term "security" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by a corporation or a government or political subdivision thereof, with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(5) Tax lien filing. The term "tax lien filing" means the filing of notice (referred to in subsection (a)) of the lien imposed by section 6321 [26 USCS § 6321].

(6) Purchaser. The term "purchaser" means a person who, for adequate and full consideration in money or

money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice. In applying the preceding sentence for purposes of subsection (a) of this section, and for purposes of section 6324 [26 USCS § 6324]--

(A) a lease of property,

(B) a written executory contract to purchase or lease property,

(C) an option to purchase or lease property or any interest therein, or

(D) an option to renew or extend a lease of property, which is not a lien or security interest shall be treated as an interest in property.

(i) Special rules.

(1) Actual notice or knowledge. For purposes of this subchapter [26 USCS §§ 6320 et seq.], an organization shall be deemed for purposes of a particular transaction to have actual notice or knowledge of any fact from the time such fact is brought to the attention of the individual conducting such transaction, and in any event from the time such fact would have been brought to such individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with

the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

(2) Subrogation. Where, under local law, one person is subrogated to the rights of another with respect to a lien or interest, such person shall be subrogated to such rights for purposes of any lien imposed by section 6321 or 6324 [26 USCS § 6321 or 6324].

(3) Forfeitures. For purposes of this subchapter [26 USCS §§ 6320 et seq.], a forfeiture under local law of property seized by a law enforcement agency of a State, county, or other local governmental subdivision shall relate back to the time of seizure, except that this paragraph shall not apply to the extent that under local law the holder of an intervening claim or interest would have priority over the interest of the State, county, or other local governmental subdivision in the property.

(4) Cost-of-living adjustment. In the case of notices of liens imposed by section 6321 [26 USCS § 6321] which are filed in any calendar year after 1998, each of the dollar amounts under paragraph (4) or (7) of subsection (b) shall be increased by an amount equal to--

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) [26 USCS § 1(f)(3)] for the calendar year, determined by substituting "calendar year 1996" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $ 10, such amount shall be rounded to the nearest multiple of $ 10.

(j) Withdrawal of notice in certain circumstances.

(1) In general. The Secretary may withdraw a notice of a lien filed under this section and this chapter [26 USCS §§ 6301 et seq.] shall be applied as if the withdrawn notice had not been filed, if the Secretary determines that—

(A) the filing of such notice was premature or otherwise not in accordance with administrative procedures of the Secretary,

(B) the taxpayer has entered into an agreement under section 6159 [26 USCS § 6159] to satisfy the tax liability for which the lien was imposed by means of installment payments, unless such agreement provides otherwise,

(C) the withdrawal of such notice will facilitate the collection of the tax liability, or

(D) with the consent of the taxpayer or the National Taxpayer Advocate, the withdrawal of such notice would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.

Any such withdrawal shall be made by filing notice at the same office as the withdrawn notice. A copy of such notice of withdrawal shall be provided to the taxpayer.

(2) Notice to credit agencies, etc. Upon written request by the taxpayer with respect to whom a notice of a lien was withdrawn under paragraph (1), the Secretary shall promptly make reasonable efforts to notify credit reporting agencies, and any financial institution or creditor whose name and address is specified in such request, of the withdrawal of such notice. Any such request shall be in such form as the Secretary may prescribe.

HISTORY:

(Aug. 16, 1954, ch 736, 68A Stat. 779; Feb. 26, 1964, P.L. 88-272, Title II, § 236(a), (c)(1), 78 Stat. 127, 128; July 5, 1966, P.L. 89-493, § 17(a), 80 Stat. 266; Nov. 2, 1966, P.L. 89-719, Title I, § 101(a), 80 Stat. 1125; Oct. 4, 1976, P.L. 94-455, Title XII, § 1202(h)(2), Title XIX, § 1906(b)(13)(A), Title XX, § 2008(c), 90 Stat. 1688, 1834, 1892; Nov. 6, 1978, P.L. 95-600, Title VII, § 702(q)(1), (2), 92 Stat. 2937, 2938; Oct. 22, 1986, P.L. 99-514, Title XV, § 1569(a), 100 Stat. 2764; Nov. 10, 1988, P.L. 100-647, Title I, § 1015(s)(1), 102 Stat. 3573; Nov. 5, 1990, P.L. 101-508, Title XI, §§ 11317(b), 11704(a)(26), 104 Stat. 1388-458, 1388-519; July 30, 1996, P.L. 104-168, Title V, § 501(a), 110 Stat. 1460; July 22, 1998, P.L. 105-206, Title I, § 1102(d)(1)(A), Title III, § 3435(a), (b), 112 Stat. 704, 760, 761.)

***3722** P.L. 89-719, FEDERAL TAX LIEN ACT OF 1966
House Report (Ways and Means Committee) No. 89-1884,
Aug. 24, 1966 (To accompany H.R. 11256)
Senate Report (Finance Committee) No. 89-1708,
Oct. 11, 1966 (To accompany H.R. 11256)
Cong. Record Vol. 112 (1966)
DATES OF CONSIDERATION AND PASSAGE
House Sept. 12, Oct. 20, 1966
Senate Oct. 13, 1966
The Senate Report is set out.

(CONSULT NOTE FOLLOWING TEXT FOR INFORMATION ABOUT OMITTED MATERIAL. EACH COMMITTEE REPORT IS A SEPARATE DOCUMENT ON WESTLAW.)

SENATE REPORT NO. 89-1708

Oct. 11, 1966

THE Committee on Finance, to which was referred the bill (H.R. 11256) to amend the Internal Revenue Code of 1954 with respect to the priority and effect of Federal tax liens and levies, and for other purposes, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. GENERAL STATEMENT

The bill as reported by your Committee makes one amendment to the bill as passed by the House. This amendment is with respect to the place of filing (and of refiling, discussed in A.6 and A.7 below) notice of a tax lien.

The Federal Tax Lien bill of 1966 represents the first comprehensive revision and modernization of the provisions of the internal revenue laws concerned with the relationship of Federal tax liens to the interests of other creditors.

Since the adoption of the Federal income tax in 1913, the nature of commercial financial transactions has changed appreciably. Business practices have been substantially revised and, as a result, many new types of secured transactions have been developed. In an attempt to take into account these changed commercial transactions, and to secure greater uniformity among the several States, a Uniform Commercial Code was promulgated somewhat over 10 years ago by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. A revised version of this code is already law in over 40 States and could well be adopted by many of the remaining States in the near future. Under the Commercial Code, priority now is afforded new types of commercial secured creditors not previously protected.

This bill is in part an attempt to conform the lien provisions of the internal revenue laws to the concepts developed in this Uniform Commercial Code. It represents an effort to adjust the provisions in the internal revenue laws relating to the collection of taxes of delinquent persons to the ***3723** more recent developments in commercial practice (permitted and protected under State law) and to deal with a multitude of technical problems which have arisen over the past 50 years. The bill represents the culmination of a project initiated approximately 10 years ago by those concerned with the relationship of the tax lien provisions to the interests of other creditors. Since that time, the suggestions and ideas of various groups have been studied and analyzed carefully, both by the groups themselves and by the staffs of the Treasury Department and the congressional committees.

Under present law, a lien for Federal taxes arises when a taxpayer's liability is assessed. The lien attaches to all of the property he then holds or subsequently acquires. The assessment is made when the unpaid tax liability is entered on the appropriate records of the Internal Revenue Service-- which occurs, in the case of a taxpayer who voluntarily shows the tax liability on his return, shortly after the time the return is filed. Although the lien arises on the date of assessment, present law provides that purchasers and certain categories of secured creditors are given priority over the tax lien up to the time a notice of the tax lien is filed in the appropriate local office as designated by State law. Mortgagees, pledgees, purchasers, and judgment lien creditors are given this priority status. In addition, in the case of securities and motor vehicles, present law provides that even a filed Federal tax lien is not generally to be effective as against a purchaser or a mortgagee or pledgee of securities or a purchaser of motor vehicles.

This bill substantially improves the status of private secured creditors. This is accomplished, first, by expanding the categories of creditors protected as against a nonfiled tax lien to include a mechanic's lienor.

Second, various types of secured creditor interests already having, or given, priority status over tax liens are specifically defined, and it is provided that where those interests qualify under the definitions they are to be accorded this priority status whether or not they are in all other respects definite and complete at the time notice of the tax lien is filed.

Third, the bill adds to the 'superpriority' status accorded to certain interests in securities and motor vehicles an additional eight categories of interests in properties which are to be effective as against a tax lien, even though notice of the lien has been filed.

Fourth, a priority status is provided for interests arising under three types of financing agreements entered into before the tax lien filing-- commercial transactions financing, real property construction or improvement financing, and obligatory disbursements-- even though the funds are advanced or the property comes into existence after the tax lien filing. In the case of commercial transactions financing, the protection generally is afforded even though the property underlying the lien is not yet in existence or is turned over within a short time (45 days) after the tax lien filing as long as the loan or purchase is made within this time. In the absence of this grace period, commercial factors and other lenders would have to check on a daily basis to see if a tax lien is filed to protect their interests. Interests arising under the real property construction and improvement financing agreements are protected even though loans are made after the tax lien filing because the construction is expected to enhance the value of the property underlying the tax lien. Interests arising under an obligatory disbursement agreement are protected because a person is obliged under ***3724** a preexisting agreement to make disbursements after a tax lien filing and someone other than the taxpayer has relied on this obligation.

Fifth, a limited type of priority is given by the bill with respect to two other categories. In the case of security interests, generally, protection is afforded for a period of up to 45 days after the filing of notice of a tax lien. Also, interest paid with respect to interests having priority over a Federal tax lien and costs of preserving property subject to interests having priority over a tax lien are given a priority over tax liens even though notice has been filed (where these items have the same priority as principal debt under State law).

In addition to dealing with relative priority of creditors' interests as against Federal tax liens, the bill also makes numerous modifications in the provisions of the internal revenue laws dealing with the procedures to be followed in collecting the taxes of a delinquent person. In general terms, these modifications are intended to represent a reasonable accommodation of the interests of the Government in collecting the taxes of delinquent taxpayers with the rights of the taxpayers and third parties. The modifications are concerned with the procedures for levying upon property of a delinquent taxpayer, the liability of lenders, sureties, etc., for withholding taxes, the running of the statute of limitations in the case of delinquent tax liabilities, procedures arising out of, or with respect to the sale of property of delinquent taxpayers, the court procedures to be followed with respect to tax liens, and provision for the redemption of real property by the United States, where it is sold by a creditor with a higher priority.

The Treasury Department urges the adoption of this bill.

II. GENERAL EXPLANATION

A. PRIORITY OF LIENS (SEC. 101 OF THE BILL AND SEC. 6323 OF THE CODE)

(1) Interests having priority over tax liens (sec. 6323(a) of the code)

The Federal tax lien arises at the time a tax is assessed. However, present law lists certain categories of persons, whose interests arise after the Federal tax lien but before the Internal Revenue Service files a notice of the lien, who are given priority over the tax lien.

Under the bill, persons to be accorded priority over a tax lien include purchasers, judgment lien creditors, mechanic's lienors, and holders of security interests. Purchasers and judgment creditors (which has been interpreted as meaning judgment 'lien' creditors), as well as mortgagees and pledgees (which under the bill are included as holders of security interests), already have this priority status under present law. The inclusion of mechanic's lienors expands somewhat the categories protected under present law. The definition of the term 'purchaser' makes clear that a purchaser who has not taken title to, or fully paid for, property is protected. The substitution of 'holder of a security interest' for 'mortgagee' and 'pledgee ' replaces the latter terms with a more general term used in the Uniform Commercial Code. [FN1] More important, however, it is intended that, under the bill, the various types of interests defined in this provision are to have a priority over a nonfiled Federal tax lien if they come within the definitions ***3725** of these terms (discussed in No. 8 below), whether or not in all other regards they are definite and complete at the time notice of the tax lien is filed.

Although so-called purchase money mortgages are not specifically referred to under present law, it has generally been held that these interests are protected whenever they arise. This is based upon the concept that the taxpayer has acquired property or a right to property only to the extent that the value of the whole property or right exceeds the amount of the purchase money mortgage. This concept is not affected by the bill.

(2) 'Superpriorities,' or cases where tax lien is invalid even though notice filed (sec. 6323(b) of the code)

As previously indicated, present law provides that a Federal tax lien is not valid against holders of specified types of interests (those described in No. 1 above) unless notice of the lien if filed. In addition, in the case of securities and motor vehicles, present law provides that tax liens are not valid against purchasers of these forms of property and holders of certain interests in securities, even though notices of these liens are filed before the competing interests arise. These interests can be said to have 'superpriorities.' The bill retains these 'superpriorities' for securities and motor vehicles and adds the following eight additional 'superpriorities.'

There may be some overlapping among categories of 'superpriorities.' In such cases, protection is to be granted if any category applies, even though another may also be relevant.

(a) Retail purchases.-- Retail purchases of property presently are not protected against a prior filed tax lien. However, your committee believes it is unreasonable to expect the average purchaser from a retailer to go to the office of the county clerk or the Federal district court and search through the tax lien records merely to be sure that no prior tax lien has been recorded. While, in fact, the Internal Revenue Service rarely attempts to trace and claim this property after it is in the hands of individual purchasers, your committee sees no reason to have this potential liability hanging over these retail purchases. To remove this potential liability, the bill gives the purchaser of tangible personal property sold at retail in the ordinary course of the seller's trade or business a 'superiority' unless the purchaser intends the transaction to, or knows that it will, interfere with the collection of Federal internal revenue taxes.

(b) Casual sales.-- A second new category of superpriority relates to casual sales. As readers of newspaper classified columns can testify, many items are sold by their owners at casual sales, often on the owners' premises. Under present law, a Federal tax lien which has attached to property follows the property, and if a notice of lien is properly filed, the lien takes precedence over the rights of a subsequent bona fide purchaser, even in the case of a casual sale. Your committee has been informed that, as a practical matter, the Internal Revenue Service rarely proceeds against the purchaser unless the item involved has substantial value. The decision as to when to proceed against a purchaser varies from case to case based upon the view of the collector of the probable costs of the collection proceedings as against the value expected to be realized by the Internal Revenue Service upon the sale of the property seized. As in the case of retail sales, your committee believes it is unreasonable to require a casual ***3726** purchaser to examine the tax records before making a relatively small purchase. As a result, your committee has decided to provide statutory protection to the purchaser of property in the case of a casual sale if the sale price is less than $250 and if the property is the type which would be exempt from levy. The principal types of property in this category are household goods, personal effects, books and tools of a business, wearing apparel, schoolbooks, etc. However, this protection is not provided for a purchaser who is a dealer, or a purchaser who has actual notice or knowledge (defined in the bill and discussed in No. 8 below) of the existence of the Federal tax lien, or a purchaser who knows that the sale is one of a series. The purchaser who is a dealer does not represent the type of sale intended to be covered by this provision. Nor is it intended to cover a purchaser who specifically knows of the tax lien at the time of his purchase. Similarly, the provision does not cover a purchase where the purchaser knows that it is one of a series of sales since, in such cases, the series of sales itself may be an indication that the seller is having credit problems. By providing this superpriority for casual sales up to a $250 limit, your committee does not intend that the Internal Revenue Service follow casual sales into the hands of the purchaser where the amount is larger if, in the absence of this provision, the Service for administrative or other reasons would not do so.

(c) Possessory liens.-- The bill adds a third new category protecting a repairman against a filed Federal tax lien in certain cases. This is only true where local law gives a repairman (or similar person) holding continuous possession of tangible personal property a lien in order to secure payment of the repairman's charge for repairing or improving the property. In this case the repairman is protected against the Federal tax lien regardless of whether he knows of the Federal tax lien before undertaking the work, since his work can be expected to enhance the value of the property by his labor and, as a result, the value of the Federal tax lien. This superpriority is limited to the reasonable price of the job. This provision is intended to enable repairmen to undertake their work without burdening them with the duty of searching tax lien records.

(d) Real property taxes and special assessments.-- A fourth new category of superpriority is provided for real property taxes and special assessments. As a practical matter, real property taxes and special assessments imposed by local governmental authorities presently limit the value of the security real property affords to Federal tax liens. This occurs because a purchaser cannot take the property free of these local liens. Consequently, any tax sale purchaser could be expected to take into account in his bid any outstanding local property taxes and special assessments. This situation is recognized in the bill and priority is given to these taxes and assessments even as against a filed Federal tax lien. However, the priority is provided only where local law gives similar priority to real property taxes and assessments as against holders of security interests. 'Assessment' is used here in the general sense of local law (not in the more limited sense usually employed in the tax lien provisions of the Internal Revenue Code).

(e) Small repairs and improvements.-- A fifth category of superpriority is made available for improvements and small repairs of real property. ***3727** Your committee believes that it is unreasonable to expect construction workers or contractors to search for filed tax liens prior to undertaking small repair and improvement work. The basis for providing this priority is much the same as that in the case of a repairman having a possessory lien. It is believed that such a person should be permitted to rely upon the authority of an owner, who occupies his own residence, to contract for reasonable repairs and improvements to that residence without fear that his mechanic's lien will be defeated by a pre-existing tax lien. Here, too, the work is likely to add to the value of the property and, therefore, increase the Government's chances of collection.

As a result, the bill grants protection against a Federal tax lien, even where notice has been filed, in situations where the applicable local law grants a mechanic's lien. However, to limit the protection to those situations where it is clearly unreasonable to expect a search for tax liens before work is undertaken, it is required that the real property involved contain not more than four dwelling units and be occupied by the owner of the residence, and that the contract price for the entire repair or improvement be not more than $1,000.

(f) Attorneys' liens.-- A sixth new category of superpriority added by the bill relates to attorneys' fees. Federal tax liens cover all of a taxpayer's property, including causes of action and any amounts which may be owed to him under judgments or settlements of suits or other proceedings. It is believed that attorneys whose efforts result in obtaining or collecting judgments or settlements should be protected as to their reasonable fees to the extent that the fees are protected under local law. An attorney's fee in such a case can be thought of as similar in concept to the repairman's charge in that it can be expected to enhance the value of the taxpayer's property. Moreover, as in the case of a possessory lien, the efforts of the attorney may account for the realization of value by the taxpayer from the judgment or settlement. However, under the bill, in a proceeding against the Government, the Government retains its right to set off against any recoveries from it any amounts due it by the taxpayer on account of any tax or any other debt or claim. This setoff means that the attorney's lien superpriority does not apply with respect to judgments he obtains for the taxpayer against the Government.

(g) Certain insurance contracts.-- A seventh new type of superpriority is provided in the case of certain insurance contracts. The bill provides that filed tax liens are not to be valid in the case of life insurance, endowment, or annuity contracts as against the insurance company carrying the contract where any of three conditions exist. First, priority is given to the insurance company where it makes a loan on the policy, even though a notice of tax lien has previously been filed, as long as the company has no actual notice or knowledge of the lien at the time the loan is made. This makes it unnecessary for an insurance company to check when a policy loan is made to see that notice of a tax lien has not been filed. Second, priority is given to the insurance company even where it has notice or knowledge of the filing of notice of a tax lien, but only with respect to automatic premium loans (including interest) required by preexisting contract to be made to maintain the insurance in force. Where there is a preexisting agreement, it appears appropriate to give recognition to the loans made to keep the *3728 policy in effect in determining the priority status of tax liens. Third, once there is a tax levy on an insurance contract and the levy is satisfied, the insurance company is to have priority for any subsequent policy loans until the Treasury Department delivers to the insurance company a new notification of tax lien on the policy. This is to avoid the necessity of an insurance company having to check on whether the tax liability has in the meanwhile been paid in each case where there previously has been a levy on the policy.

(h) Passbook loans.-- An eighth new superpriority is provided for passbook loans. Under present law, when a taxpayer who has a savings account in a bank or building and loan association presents his passbook for a withdrawal, the bank or association may pay out the entire amount of the account without incurring any liability with respect to any outstanding lien of the taxpayer of which it has no notice or knowledge. Since a bank or association is permitted to pay out the entire account in this way without regard to the status of any tax lien on the property your committee has concluded that is is also appropriate to accord this same status to a passbook loan-- a loan secured by the taxpayer's account at the lending institution. However, the bill protects a bank or institution with regard to a passbook loan only to the extent that the loan is secured by an account with the bank or association and where the institution, in fact, retains the passbook in its possession until the loan is completely paid off. This protection is available only for passbook loans made before the bank or association obtains actual notice or knowledge of the existence of the tax lien. Where a passbook loan is made before this knowledge and the bank or association subsequently obtains knowledge, this protection is not to attach to any additional loans made after the knowledge is acquired, even if the bank continues to retain the passbook from the preceeding, protected, passbook loan.

(3) Interests under commercial transactions financing agreement, etc., coming into existence after tax lien filing (sec. 6323(c) of the code)

In addition to the interests which are protected when they arise after the assessment of a tax but before tax lien filing (those of purchasers, holders of security interests, mechanic's lienors and judgment lien creditors), and the superpriorities, discussed above, which are protected even though they arise after tax lien filing, the bill provides priority for certain other interests. It provides that security interests arising under commercial transactions financing agreements, real property construction or improvement financing agreements, and obligatory disbursing agreements entered into before tax lien filing in certain cases are to be protected against Federal tax liens, even though the funds are advanced under the agreement, or the property referred to in the agreement comes into existence, after the tax lien filing.

The priority over filed tax liens for advances made after, or with respect to property coming into existence after, the filing of a tax lien is to occur only if local law gives priority in such cases. This protection under local law must be provided against a judgment lein creditor as of the time of the tax lien filing for the priority to be available.

(a) Commercial transactions financing agreement.-- As indicated above, protection as against a filed tax lien is provided for a security interest arising ***3729** out of three different types of agreements. The first of these is a commercial transactions financing agreement. This is an agreement, entered into in the ordinary course of the lender's trade or business, to make a loan secured by commercial financing security or to purchase commercial financing security (other than inventory), but protection is afforded only where the loan or purchase is made not later than 45 days after the tax lien filing (unless actual notice or knowledge of the filing is obtained sooner) and only where the inventory, accounts receivable, etc., are acquired before the 45 days have elapsed.

Commercial financing security is defined as accounts receivable, mortgages on real property, inventory, and paper of a kind ordinarily arising in commercial transactions.

In the case of inventory and accounts receivable financing, it is customary for a business, after establishing a line of credit, to receive advances from time to time as its needs arise. The security in such a case customarily is the inventory, accounts receivable, etc., which the business receives from time to time in the ordinary course of its business. The loan may be secured by these assets (including replacements of the initial assets) or these assets themselves (except inventory) may be sold to the financier. Under present law, a filed tax lien has priority over the rights of the lender or purchaser if the funds are not advanced, or the security purchased, until after the tax lien filing. In addition, it has priority under present law if the initial assets are replaced with assets acquired after the tax lien filing. As a result, under present law for a lender or purchaser to be sure that no tax lien has recently been filed, he must search the records each time before making an additional advance or purchase. The provision added by the bill is designed to keep this obligation within practical bounds by giving the interests arising under the agreements providing for these loans or purchases priority over a filed tax lien if the loans or purchases are made not later than 45 days after the tax lien filing and before the lender or purchaser has actual notice of the filing. In this regard it should be noted that the standard of perfection (i.e., validity against judgment liens) in this regard is the same for a purchaser (including a bona fide purchaser) as it is for the holder of a security interest. This provision thus generally gives an inventory or accounts receivable, etc., financier assurance that his loans or purchases are not inferior to some recently field tax lien as long as he searches the records at least once every 45 days.

(b) Real property construction or improvement financing agreement.-- A second type of interest given priority over a filed lien is an interest arising under a real property construction or improvement financing agreement. In this case, also, the interest is given priority over a filed tax lien even though the cash disbursements involved are made after filing, but in this case without regard to whether the disbursements occur within 45 days of the tax lien filing. The types of financing agreement covered are generally those involving disbursements to an owner of a property for the construction or improvement of real property, or to a builder for a contract to construct or improve real property, as well as disbursements for the raising or harvesting of farm crops or the raising of livestock or other animals. Protection is limited to interests arising ***3730** from cash disbursements by the lender except in the case of the financing of a farm crop, livestock, or other animals, where the disbursement may also be in the form of the supplying of goods or services.

Your committee's bill give priority in the case of security interests arising from disbursements for these purposes even though a notice of a tax lien has been filed because (as in the case of some of the superiority categories) the disbursements generally enhance the value of the property for purposes of the tax lien. Thus, the completion of the construction or the improvement of the property or the completion of the raising of the crop or livestock usually increases the value of the property underlying the security interest for tax lien purposes by more than the amount of the disbursement being accorded the priority.

(c) Obligatory disbursement agreement.– The third category of interest given priority over a filed tax lien is that arising from an obligatory disbursement agreement. This is an agreement entered into by a person under which he is obliged to make disbursements because someone other than the taxpayer has relied on his obligation. An example is an irrevocable letter of credit where a bank issuing the letter must honor a demand for payment by a third party who advances credit in reliance upon the letter. This also covers cases where a surety agrees to finance the completion of a contract entered into by the taxpayer. In these cases no limitation is placed on the time during which a disbursement may be made as long as the person is obligated to do so at the time of the tax lien filing by a written agreement. As a result, if an effort is made to foreclose on a Federal tax lien before all of the potential obligations under an obligatory disbursement contract are met, these potential obligatory disbursements are given priority over the Federal tax lien. In such a case an amount sufficient to cover the potential obligations usually is set aside and used for these obligations. Only after these obligations have been met is any remainder available to satisfy the liability secured by the Federal tax lien.

Your committee's bill gives priority to interests arising under obligatory disbursement agreements as against filed tax liens since the obligation arises before the filing of the tax lien, although the disbursements are made after that time. Interests arising under these agreements are given priority over a filed tax lien only if the agreements are entered into by the disburser in the ordinary course of his trade or business. As a result, this provision does not apply in the case of accomodation endorsers to the extent the accomodation is not incidental to the operation of a trade or business. The priority over the tax lien in these cases also applies only to the extent of the property on hand at the time of tax lien filing (and put up as security) and property traceable to the obligatory disbursements. Thus, if a bank issues a line of credit to allow a taxpayer to finance the purchase of specified property and, subsequently, must make this disbursement, priority as against the tax lien is given only with respect to the property pledged and the specific property purchased and other property directly traceable to funds obtained from the sale of this specific property.

(4) 45-day period for the disbursements with respect to security interests generally (sec. 6323(d) of the code)

In addition to the priorities previously discussed, the bill also provides priority generally with respect to security interests in property held by the *3731 taxpayer before the tax lien filing which arises as a result of disbursements made within a period of up to 45 days after the filing of a tax lien (unless actual notice or knowledge of the filing is sooner obtained). However, for the priority to exist in such cases there must be a written agreement entered into before the tax lien filing and the security interest must be protected under local law against a judgment lien arising as of the time of the tax lien filing. The protection provided here, as in the case of the commercial transactions financing agreements, is designed to make it unnecessary for the holder of the security interest to search the records more often than once every 45 days where one or more disbursements are to be made by him.

(5) Priority of interest and expenses (sec. 6323(e) of the code)

The bill also provides a priority over filed tax liens for interest with respect to, and certain other costs of preserving property underlying, a lien or security interest which is superior to a Federal tax lien. For this priority to exist, however, a local law must also provide this interest or expense the same priority as the lien or security interest to which it relates. The types of items referred to here are—

(1) Interest or carrying charges (including finance and service charges) on the obligation secured by a lien or security interest;

(2) Reasonable expenses of an indenture trustee (such as a trustee under a deed of trust) or agent holding a security interest;

(3) Reasonable expenses incurred in collecting and enforcing a secured obligation (including reasonable attorney's fees);

(4) Reasonable cost of insuring, preserving, or repairing the property subject to the lien or security interest;

(5) Reasonable costs of insuring payment of the obligation secured (such as mortgage insurance); and

(6) Amounts paid by the holder of a lien or security interest to satisfy another lien on the property where this other lien has priority over the Federal tax lien.

These interest charges and expenses arise out of a lien or security interest having priority over the Federal tax lien, and your committee believes that, although they are not fully determinable as of the time notice of the Federal tax lien is filed, nevertheless, they should be given priority since they relate to a lien or security interest having such a priority.

(6) Place of filing notice (sec. 6323(f) of the code)

The bill is reported by your committee makes a change in the bill as passed by the House with respect to the place of filing notice of a Federal tax lien. The House bill made no change in present law in this regard. Your committee has made an amendment, contained in the bill as it was originally introduced in the House, designed to clarify existing law and to increase the likelihood that creditors, generally, will receive notice as to taxpayers' standing with the Government. It should be noted in considering this point that in anticipation of the enactment of this amendment, your committee understands that many States are planning to enact a uniform act for filing notice of tax liens.

Under present law, for notice of a tax lien to be effective, it must be filed in the office designated by the law of the State where the property subject to the lien is situated. Where the State has not designated an appropriate office, notice of the lien is required to be filed with the clerk of ***3732** the Federal district court. In the latter case, too, the place of filing is determined by where the property subject to the lien is deemed to be situated.

The Internal Revenue Service takes the position that real property is situated where it is physically located. On this point there is no dispute. There is some dispute, however, as to where personal property, both tangible and intangible, is situated. The Service takes the position that as to both types of personal property, the domicile of the taxpayer determines the situs of the property. It further takes the position that, under existing law, a State may designate only one office for filing of notice of tax liens. Thus, the Service contends that as to the personal property of a taxpayer, notice of a Federal tax lien is valid as against all persons when the notice is filed in one office designated by the laws of the State where the taxpayer is domiciled. If the State designates more than one office, the Service takes the position that is is as if the State did not designate any office, and thus that the place to file a notice of lien is with the clerk of the appropriate Federal district court.

In most cases the courts have sustained the Revenue Service's interpretation of existing law and have held that the filing of notice of a tax lien against personal property was valid when filed at a taxpayer's domicile. In some cases, however, the courts have held that a filing of notice was not valid respect to a particular property of a taxpayer where the property was deemed to be situated elsewhere than at the taxpayers' domicile. [FN2] These conflicting authorities have created uncertainty not only for the Government but also for creditors, who, as a result, do not know where to look in order to determine if notice of a tax lien is on file.

The amendment made by your committee clarifies existing law by providing specific rules with respect to the place of filing a notice of a Federal tax lien against both real and personal property. As against real property, a notice of tax lien is to be filed in the one office designated by the State where the property is physically located. As against (all types of) personal property, a notice of tax lien is to be filed in the one office designated by the State where the taxpayer resides. In either case, where the State designates more than one office, notice of the lien is to be filed with the appropriate Federal district court.

The amendment requires notice of a tax lien to be filed where a taxpayer resides, and not at his domicile, as presently contended by the Internal Revenue Service, because of the difficulty in determining a person's domicile, based as it is on (among other things) his state of mind. On the other hand, for purposes of determining the residence of corporations and partnerships, the amendment provides specific rules for determining their residence. Under the amendment, the residence of a corporation or a partnership is deemed to be the place at which its principal executive office is located. This is the most readily identifiable of all offices that a business may maintain, appearing, as it does, on the annual reports filed with most States and on similar returns, and avoids the uncertainty of determining which of the many business offices that a taxpayer may maintain is its principal one.

***3733** The amendment made by your committee also provides a rule for determining the residence of a taxpayer who resides out of the country. For purposes of filing a notice of tax lien, a taxpayer who resides abroad is deemed to reside in Washington, D.C. Thus, a notice of tax lien filed against his personal property is to be filed with the Recorder of Deeds for the District of Columbia.

(7) Refiling of notice (sec. 6323(g) of the code)

Public notice of the existence of a Federal tax lien is given under present law by the filing of a notice of the lien. As indicated previously, various interests may come ahead of a Federal tax lien if they arise before the filing of notice. Once the filing occurs, under present law the filing remains effective without any refiling of the notice. However, tax liens may expire, not only because the tax liability is satisfied, but also because they become unenforceable as a result of the running of the statute of limitations. Generally, the Federal Government has 6 years from the date of assessment to take action to collect the tax. As a result a potential creditor may well assume that if a notice of Federal tax lien indicates that the assessment occurred more than 6 years before his search of the records, he may then act safely on the assumption that the Federal tax lien is no longer enforceable. As a result, he may feel secure in accepting the taxpayer's property as good security for the extension of credit. However, the 6-year statute of limitations on the collection of a Federal tax after assessment may be extended by agreement with the taxpayer or where the running of the statute of limitations is suspended, such as where the taxpayer is out of the country for at least 6 months (this latter exception is a modification of present law discussed in F(2), below). As a result, it is not unusual for a tax lien to be valid for more than 6 years after it arises.

To remove this potential source of uncertainty for creditors, the bill as passed by the House provides that the Internal Revenue Service is to be required to refile its notice of lien in the same office where the original notice is filed within the 1-year period ending 30 days after the expiration of the 6-year period beginning with the date of assessment of the tax. This must recur every 6 years after the first required refiling where the lien continues for the lien to retain its priority. The failure to refile the tax lien at the appropriate time is not to affect the validity of the lien itself. However, it nullifies the effect of the prior filing of the notice of the tax lien. Any timely refiling of a tax lien, in effect, represents a continuation of the prior filing, but any late refiling of a tax lien, in effect, constitutes a new filing. As a result, in the case of a late refiling, any security interest arising after the prior filing of the tax lien, but before the refiling, obtains a priority to the same extent and under the same conditions as if no tax lien had been filed prior to the time of the late refiling.

Your committee has accepted the amendment made by the House requiring the refiling of notice of a Federal tax lien. Under your committee's bill, however, in addition to requiring refiling of notice of a tax lien in the same office where the original notice was filed, in those cases where a taxpayer has moved, the bill also requires refiling in the one office designated by the State where the taxpayer resides at the time of the required refiling. This additional refiling is required only where the Internal Revenue Service has received written notice (in the manner prescribed by regulation) concerning ***3734** the taxpayer's change of residence more than ninety days prior to the actual refiling. In this regard, your committee understands the regulations will provide that a written notice (such as a tax return, an amended tax return, or other written communication) is sufficient to advise the service of a change of address if the notice identifies the taxpayer and is with reference to the same type of tax out of which the lien arose.

(8) Definitions and special rules (sec. 6323(h) and (i) of the code)

A number of terms relating to the provisions discussed to this point are defined in the bill. The more significant of these are discussed below.

(a) Security interest.-- Under present law, mortgagees and pledgees are given priorities over tax lien, notices of which have not yet been filed. The bill, as previously indicated, applies this priority status to holders of a 'security interest.' A security interest is an interest in property acquired by contract for the purpose of securing payment or performance of an obligation or as indemnification against loss or liability. This term, which includes mortgagees and pledgees, is sued to substantially conform the internal revenue laws in this respect to the terminology of the Uniform Commercial Code. It is intended that if a Federal tax lien is invalid against an initial holder of a security interest, it also is to be invalid to the same extent against any person who succeeds to the interest of the initial holder, whether by purchase or otherwise.

A security interest is considered as arising when the following conditions are met:

(1) the property [FN3] is in existence and the interest is protected under local law against a subsequent judgment lien arising out of an unsecured obligation; and

(2) To the extent the holder has parted with money or money's worth. [FN4]

For Federal tax purposes, a security interest is not considered as existing until the conditions set forth here are met even though local law may relate a security interest back to an earlier date and even though it might be an effective security interest as of the earlier date under the Uniform Commercial Code.

(b) Mechanic's lienor.-- Under the bill a 'mechanic's lienor' is a person who, under local law, has a lien on real property (or on the proceeds of a contract relating to real property) for furnishing services, labor, or materials in connection with the construction or improvement of the property. A mechanic is considered to have this lien under the bill as of the time the mechanic begins to furnish services, labor or materials, or, if later, the time when his lien is effective under local law. This protects mechanics under most State laws, where the mechanic's lien arises as of the time when the mechanic commences his labor or begins supplying material, even though he does not perfect his lien (such as by filing or by securing a judgment) until long after this time.

(c) Purchaser.-- The bill adds a definition of 'purchaser,' a term which appears in present law but is not defined for purposes of the provisions relating ***3735** to tax liens. A purchaser is defined as a person who, for adequate and full consideration in money or money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law as against subsequent purchasers without actual notice. By requiring 'adequate and full consideration,' the bill modifies the results reached in court decisions under present law in that the amount paid can no longer be so small as to have little relation to the value of the property acquired. However, this requirement is not intended to preclude a bona fide bargain purchaser or a purchaser who has not completed performance of his obligation, such as the completion of his installment payments. The term 'purchaser' as used here includes one who has acquired a lease of property, an executory contract to purchase or lease property, one who has an option to purchase or lease property or an interest in it, or one who has an option to renew or extend a lease on property if the interest acquired is not a lien or a security interest. Thus, for example, the holder of an option is not to lose the right to acquire the property at the option price.

(d) Actual notice or knowledge.-- In a number of places in the bill, rights are made to depend upon whether or not a person has 'actual notice or knowledge ' of a certain fact. Your committee has adopted the Uniform Commercial Code definition of this concept (as revised in the proposed 1962 amendments to the Uniform Commercial Code). The burden is to be upon the Internal Revenue Service to show the existence of actual notice or knowledge, wherever actual notice or knowledge is material in determining the priority of a Federal tax lien versus a competing lien or interest.

(e) Subrogation.-- If local law permits one person to acquire by substitution the rights to another with respect to any lien or interest dealt with here, then the person substituted is to stand in the shoes of the person he replaces with regard to Federal tax liens.

B. SPECIAL LIENS FOR ESTATE AND GIFT TAXES (SEC. 102 OF THE BILL AND SEC. 6324 OF THE CODE)

Present law (sec. 6321) provides that when a person liable to pay a Federal tax refuses or neglects to do so after demand, the amount of the tax (plus interest, penalties, etc.) is to constitute a lien against all his property. This applies to liabilities for all Federal taxes and is typically referred to as 'the Federal tax lien.' In addition, present law (Sec. 6234) provides special liens for estate and gift taxes.

The bill amends the provision relating to the special liens for estate and gift taxes, first, to make it clear that these special liens are extinguished after the running of the period of limitations on the collection of the underlying estate or gift tax liability and, second, to extend to additional categories of interests the same protection against the special estate and gift tax liens which these interests are accorded by the bill in the case of the general tax lien.

Present law provides that unless the estate and gift taxes due are paid in full at an earlier date, they are to be a lien (without tax lien filing) for 10 years from the date of death, upon the gross estate of the decedent, or for 10 years from the time the gift is made, on all gifts made during the year. The bill adds a phrase in these provisions making it clear that these special liens are to terminate before the expiration of the 10 years ***3736** at any time the estate or gift tax liability becomes unenforceable by reason of the running of the statute of limitations on collection (usually a 6-year period after assessment).

The bill also conforms in certain respects the special liens for estate and gift taxes to changes made by the bill in the general tax lien provisions. Under present law, property transferred from an estate tax has not been paid in full. In the case of gifts, the donee is personally liable for the gift tax, if not paid by the donor, to the extent of the value of the gift. However, in both of these cases, exceptions under present law are made for property transferred to purchasers, mortgagees, or pledgees. The bill substitutes 'a holder of a security interest' for the references to 'mortgages ' with 'pledgees' (since this is the concept used in the general tax lien provision and also is the term used in the Uniform Commercial Code) and also defines the term 'purchaser.'

Under present law, the special liens for estate and gift taxes are not valid with respect to a security, as against a mortgagee, pledgee, or purchaser of the security for adequate and full consideration, if, at the time of the mortgage, pledge, or purchase, the mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of the liens. A similar exception is provided by present law in the case of purchasers of motor vehicles who are without notice or knowledge of the lien at the time of acquiring possession of the motor vehicle. In the discussion of the general tax lien above, the exceptions with respect to securities and motor vehicles are referred to as 'superpriorities.' In addition, in the case of the general tax lien, eight other categories of superpriorities are added by the bill. These eight categories are also added by the bill as exceptions in the case of the special liens for estate and gift taxes. An exception is also provided for a mechanic's lien and for interest and expenses attributable to a lien or security interest to the extent these interests or expenses under local law are treated as a part of the lien or security interest itself. Both the mechanic's lien and the priority for interest and expenses are the same exceptions as are provided by the bill with respect to the general tax lien provision.

C. CERTIFICATES OF RELEASE OF LIENS (SEC. 103 OF THE BILL AND SEC. 6325 OF THE CODE)

Present law provides the conditions under which a tax lien may be released and property may be discharged from the lien. The bill amends these provisions to provide new rules for the discharge of property, to authorize the subordination of tax liens in certain cases, to provide a procedure for the issuance of certificates of nonattachment of a tax lien, and to provide new rules relating to the legal effect of the various certificates issued under this provision.

(1) Discharge of property (sec. 6325(b) of the code)

Present law permits the Internal Revenue Service to issue a certificate of discharge of property subject to a Federal tax lien if (1) the fair market value of the property remaining subject to the lien is at least double the amount of the unsatisfied tax liability, or (2) the Internal Revenue Service is paid the value of the Government's interest in the property or determines ***3737** that this interest has no value. In determining 'value' for purposes of the latter rule, present law provides that 'fair market value' is to be used. The bill substitutes the single word 'value,' so the Internal Revenue Service may take into account 'forced sale value,' as well as other values, as an alternative to 'fair market value,' in appropriate cases.

The bill also authorizes the Internal Revenue Service to issue a certificate of discharge where property subject to a tax lien is sold and, under an agreement with the Internal Revenue Service, the proceeds from the sale are to be held as a fund subject to the liens and claims of the United States in the same manner, and with the same priority, as the liens and claims on the discharged property. This new procedure should aid in the disposition of property where a dispute exists among competing lienors, including the Untied States, concerning their rights to specific property.

(2) Subordination of lien (sec. 6325(d) of the code)

The bill adds a new provision authorizing the Internal Revenue Service to issue certificates subordinating a tax lien to another interest where there is paid over to the Internal Revenue Service an amount equal to the amount with respect to which the tax lien is subordinated. Certificate subordinating a tax lien to another interest may also be issued where the Internal Revenue Service believes that the subordination of the tax lien to another interest will ultimately result in an increase in the amount realized by the United States form the property subject to the lien and will aid in the collection of the tax liability.

Both of these rules permitting subordination of tax liens are designed to facilitate collection of delinquent tax liabilities by providing more flexible procedures. In the first case, since the tax lien is being subordinated only to the extent the United States receives, on a dollar-for-dollar basis, an equivalent amount, the U.S. interest cannot in any event be injured and a new procedure for collecting taxes is made available. Permitting a Federal tax lien to be subordinated to another interest where the Internal Revenue Service believes this will ultimately aid in the collection of the tax is designed to give the Service flexibility so that, for example, funds may be borrowed to increase the value of the property subject to the tax lien. This may occur, for example, in the case of a crop which needs harvesting and without which the tax lien of the Government has little or no value. It is intended that this authority will be used by the Service under conditions similar to those under which an ordinary, prudent businessman would subordinate his rights in a debtor's property in order to secure additional longrun benefits.

(3) Nonattachment of lien (sec. 6325(e) of the code)

The bill adds a new provision to the law codifying the present administrative practice of the Internal Revenue Service of issuing certificates of nonattachment of a tax lien on property where there has been confusion, such as because of the similarity of the name of an individual whose property is not subject to a tax lien and the name of an individual whose property is subject to a tax lien.

(4) Effect of, and procedures for filing, certificates (sec. 6325(f) and (g) of the code)

Present law provides that where a certificate of release of a tax lien, or a certificate of discharge of property, is issued, the certificate is to be ***3738** conclusive that the tax lien referred to is extinguished or that the property is discharged from the tax lien. The bill adds similar rules in the case of certificates of subordination and certificates of nonattachment, specifying that where these certificates are issued they are conclusive that the lien or interest to which the tax lien is subordinated is superior to the tax lien, or that the lien does not attach to the property of the person referred to in the certificate.

The bill also makes provisions for the revocation of certificates of release or nonattachment in certain cases. It provides that these certificates may be revoked and the Federal tax lien reinstated where a certificate of release or nonattachment is issued erroneously or improvidently, or if the certificate of release is issued in connection with a compromise which has been breached (where the period of limitations on collection of the underlying tax liability has not expired). Where a certificate is revoked, the tax lien is reinstated and has the same effect as a new general tax lien.

The bill also provides that where a certificate of discharge has been issued, in these cases where the taxpayer disposes of property, if he subsequently reacquires the property, the certificate thereafter is to have no effect and the tax lien thereafter is to apply in the same way as in the case of after-acquired property generally.

Provision also is made in the bill to permit the public recording of all certificates and notices referred to above. If the certificate or notice may not be filed in the office designated by State law with respect to the notice of lien, it is to be filed in the office of the clerk of the appropriate U.S. district court.

D. SEIZURE OF PROPERTY FOR COLLECTION OF TAXES (SEC. 104 OF THE BILL AND SECS. 6331-6343 OF THE CODE)

Under present law, the Internal Revenue Service may levy upon the property of a delinquent taxpayer to collect the amount due. This levy may take the form of distraint and seizure by any means. Present law sets forth various procedures with respect to the levy, property exempt from the levy, the procedures to be followed in the case of the sale of seized property, and the application of the funds received from the sale. The bill makes a series of modifications in this levy procedure designed to remove both problems faced by the taxpayer and problems faced by the Government under current law. These are set forth below.

(1) Effect of levy (sec. 6331(b) of the code)

In the provision of present law authorizing the Internal Revenue Service to levy upon the property of a taxpayer who owes delinquent taxes, the bill adds a sentence specifying that this right to levy extends only to property of the taxpayer and in the possession of the person on whom the levy is made, or obligations to the taxpayer of the person on whom the levy is made which are existing at the time of the levy. The bill intends to make it clear, for example, that if a levy is made upon the bank account of a delinquent taxpayer and the bank surrenders the balance in the account at the time the levy is made, this levy has no effect upon subsequent deposits made in the bank by the taxpayer. It is intended that these may be reached only by a subsequent levies.

*3739 (2) Life insurance and endowment contracts (sec. 6332(b) of the code)

Under present law, when the Government seeks to collect a taxpayer's rights in a life insurance or endowment contract which has not matured, the Government must proceed by means of a foreclosure suit against the taxpayer's total rights in the contract. This is necessary because the courts have held that to permit the Internal Revenue Service to seize the cash loan value of a policy without judicial foreclosure would, in effect, authorize it to alter an existing contractual arrangement between the taxpayer and the insurance company. However, a foreclosure suit has disadvantages both from the standpoint of the Government and the standpoint of the taxpayer. From the Government's point of view, a foreclosure suit is a cumbersome way of collecting the taxpayer's rights in the policy; from the taxpayer's point of view, such a suit is unfortunate because, when successful, it completely eliminates the insurance coverage. This is especially unfortunate if the insured becomes uninsurable between the time the policy is issued and the time of the tax lien foreclosure or if (because of greater age) the premium payments required for a new policy are substantially higher than for the old.

As an alternative procedure to the foreclosure suit, the bill permits the Government to levy against the cash loan value of the policy. This alternative procedure generally is more desirable both from the standpoint of the Government and from the standpoint of the insured. For the Government, this is an easier method of collection than a foreclosure suit.

For the taxpayer, this makes it possible to continue the policy in force by transferring it to either a beneficiary or someone else who pays the subsequent premiums and interest on policy loans, including those loans resulting from the Government levy.

Under the new procedure set forth in the bill, where the Government levies on the cash loan value of the contract, the insurance company generally must pay this cash loan value over to the Government 90 days after the levy. However, the amount to be paid over is increased (above this cash loan value) for any advances made to the insured after the insurance company has actual notice or knowledge of the tax lien. An exception to this, however, is provided for advances made automatically to keep a policy in force; these need not be added to the payment where they are provided for in a contract entered into before the insurance company has notice or knowledge of the lien.

The 90-day period before the company is to pay the cash loan value (with any appropriate adjustments) to the Government allows a period of time for the insured to meet his tax liability by other means. In this regard, it is understood that a procedure is to be worked out whereby the Internal Revenue Service is to inform the insurance company before the end of the 90-day period of amounts received in payment of these tax liabilities during the interval.

Your committee believes that this new levy procedure with respect to the cash loan value of insurance policies will both facilitate Federal tax collections and, at the same time, aid delinquent taxpayers and their beneficiaries. Nevertheless, this alternative procedure is not intended to eliminate the Government's right to make use of foreclosure suits with respect to these policies where it still deems this appropriate or necessary.

***3740** (3) Enforcement of levy (sec. 6332(c) of the code)

Present law provides that a person who fails or refuses to surrender property levied upon is personally liable to the extent of the value of the property involved, or to the extent of the underlying tax liability, if less. Because this amount is designated as a 'penalty,' there is some confusion as to whether an amount collected in this manner is properly credited against the tax liability of the person with respect to whom the levy is made.

The bill deletes the word 'penalty' in the heading of this provision and adds specific language making it clear that the amount collected under this provision is to be credited against the delinquent tax liability. This makes it clear that an amount collected from the holder of the property under this provision is not a 'penalty,' but rather a collection of part or all of the tax liability.

However, your committee believes it appropriate to provide a penalty where the person fails or refuses to surrender property without reasonable cause. As a result, the bill provides for a civil penalty, equal to 50 percent of the amount recoverable, where the holder of the property fails or refuses to surrender it without reasonable cause. In this regard, it is intended that a bona fide dispute over the amount owing to the taxpayer (by the property holder) or over the legal effectiveness of the levy itself is to constitute reasonable cause under this provision.

(4) Effect of honoring a levy (sec. 6332(d) of the code)

The bill adds a new provision to the law making it clear that where a holder of property honors a levy with respect to a delinquent taxpayer and surrenders the property to the Government he is discharged from any obligation or liability to the taxpayer with respect to this property. This includes cases where the Government levies on property under an assessment which is incorrectly determined. The bill also provides that where an insurance company honors a levy with respect to a life insurance or endowment policy, the company is to be discharged to the extent of any obligation or liability, not only with respect to the insured or other owner, but also with respect to any beneficiary under the policy. Thus, the effect of honoring the levy is the same as honoring a demand of the taxpayer.

These new provisions are not intended to remove the liability of a property holder to a third party who owns the property where the holder mistakenly surrenders the property to the Internal Revenue Service. However, where there is a surrender of this property, there is provision for administrative relief, or the person involved may bring suit to recover the property.

(5) Property exempt from levy (sec. 6334(a) of the code)

Present law lists five types of property which, either in whole or in part, are exempt from levy for the collection of delinquent taxes. These categories include wearing apparel and school books; fuel provisions, furniture, and personal effects; books and tools of a business; unemployment benefits; and undelivered mail.

The bill adds two new categories of property exempt from levy. It exempts from levy annuity or pension payments under the Railroad Retirement Act, benefits under the Railroad Unemployment Insurance Act, pension payments received by those whose names are on the Medal of Honor ***3741** Roll of the Army, Navy, Air Force, and Coast Guard, and annuities based upon retired or retainer pay paid under the retired serviceman's family protection plan. It also exempts from levy amounts paid as workmen's compensation (including amounts payable with respect to dependents) under the laws of the United States, any State, the District of Columbia, or Puerto Rico.

(6) Publication of notice of sale (sec. 6335(b) of the code)

Present law requires the Treasury Department to publish a notice of the sale of seized property in a newspaper published within the county where the property is seized. Because in recent years there has tended to be a reduction in the number of newspapers published in suburban and rural counties, it frequently happens that the only newspapers of wide circulation within these counties are those published outside of the counties in nearby metropolitan areas. To permit effective publicity to be given to tax sales in areas such as these, your committee's bill amends the law to provide, as an alternative to the present provision, that notice of these sales may be published in a newspaper generally circulated within the county in which the property is seized.

(7) Redemption of property by taxpayers (sec. 6337(b) of the code)

Where real property which is seized by the Government for delinquent taxes is sold, present law allows the owner (or others acting on his behalf) 1 year from time of sale to redeem the property by paying the purchaser the amount paid at the tax sale, plus interest of 20 percent per year.

While a reasonable period of time for redemption in these cases is desirable, nevertheless, such a long redemption period tends to unnecessarily depress the price which potential purchasers are willing to bid for property at these sales. Your committee's bill has, therefore, reduced by approximately two-thirds, or to 120 days, the period during which owners (or others acting on their behalf) may redeem their property sold at tax sales by the Government.

As is indicated subsequently, the same reduction in time is provided by the bill (in sec. 201) for the Government where it redeems real property on which it has a tax lien which has been sold in a foreclosure sale by a creditor whose interest is superior to that of the Government.

(8) Preparation of deed (sec. 6338(c) of the code)

Present law provides that where real property is declared purchased by the United States at a tax sale, the Treasury Department is to execute a deed for the property 'after its preparation and the endorsement of approval as to its form by the U.S. attorney for the district in which the property is situated. ' Then the Treasury Department is to have the deed duly recorded in the proper registry of deeds. The bill relieves the local U.S. attorneys of the requirement of preparing, and endorsing the form of, these deeds.

(9) Effect on junior encumbrances (sec. 6339 of the code)

Where, after a tax sale by the Government, a certificate of sale for personal property or a deed to real property is given, the courts have held that this discharges this property from all liens, encumbrances, and titles over which the tax lien has priority. Your committee's bill places this rule in the Internal Revenue Code.

***3742** (10) Application of proceeds of levy and sale (sec. 6342 of the code)

Present law provides that funds collected by levy and sale procedure are to be applied, first, to meet the expenses of the levy and sale; second, to meet the tax liability on the seized property; third, to meet the liability with respect to which the levy is made; and, finally, any surplus proceeds remaining are payable to the person legally entitled to them.

Although this provision presently relates only to amounts realized by the Government in connection with levy proceedings, subsequently in this bill, provision is made for the United States to redeem real property in appropriate cases where other interests have priority and then to sell this property to third parties. Your committee's bill provides that funds realized by the Government from these sales to third parties are to be applied in the same manner as in the case of funds realized from levy proceedings.

(11) Return of property after wrongful levy (sec. 6343 of the code)

Under present law, the Treasury Department is authorized to release a levy upon property where it is determined that this action will facilitate the collection of the tax liability. The bill adds a provision dealing with cases where property has been wrongfully levied upon. The usually occurs where there has been a mistake as to the ownership of the property.

The bill provides that the Treasury Department, where it determines property has been wrongfully levied upon, may return either that specific property, an amount of money equal to the amount of money levied upon, or an amount of money equal to the amount received by the Government from the sale of the property.

Where specific property is returned, it may be returned at any time. Where money is returned, it is to be returned within 9 months after the date of the levy. In those cases where money is specifically identifiable (such as a coin collection which may be worth substantially more than its face value), it is contemplated that this money is to be treated as specific property and, wherever possible, this specific property is to be returned.

Where seized property has been declared sold to the United States, because no bidder at the sale is willing to meet the minimum price, then the minimum price is to be treated for purposes of this provisions as the amount received from the sale. This is not intended, however, to prevent the return of the property itself, where it still is in the hands of the Government. Where the property is resold by the United States for greater than the minimum price, then the amount actually received from the resale (rather than the minimum price) is to be treated as the amount received in the initial tax sale.

E. LIABILITY OF LENDERS, ETC., FOR WITHHOLDING TAX (SEC. 105 OF THE BILL, SEC. 3505 OF THE CODE, AND SEC. 1 OF THE MILLER ACT; 49 STAT. 793)

(1) Liability where payments are made, or supplied, by lenders, etc. (sec. 3505 of the code)

Under present law, only 'employers' are liable for income, social security, and railroad retirement taxes required to be withheld and deducted from wages. There are cases, however, where persons other than the employers directly, or indirectly, pay the wages. Where this occurs, problems ***3743** have arisen because, in some instances, these other persons have paid employees only the 'net' wages and have not paid, either to the employees or to the Government, the withholding taxes due the Government. Under current law in these cases the employees receiving the net wages receive credit for the taxes required to be withheld, whether or not the Government is paid the amount of these taxes. While the employers in these cases are liable for the payment of the withholding taxes, they are likely to be without financial resources and, as a result, resources against them may well be fruitless. Under current law, recourse cannot be taken against the third persons who directly or indirectly paid the net wages since they are not 'employers' and, therefore, are not liable for the tax.

Your committee believes that where third persons finance employers' payrolls-- subject to the conditions set forth below-- they should be liable for the withholding taxes. It sees no reason for distinguishing between the portion of the total wages which is owed and should be paid to employees (the 'net' wages), and the portion of the wages which is owed and should be paid to the Government in the form of withholding taxes. These taxes are, in reality, a portion of an employee's wages for which he is given credit in the computation of his own tax liability; the fact that this portion of the wages is payable directly to the Government does not alter its basic nature.

Third persons who pay wages directly to employees ordinarily have full access to payroll information and, therefore, have essentially the same ability to determine the amount of wages due, and control over the funds available for payment, as is usually true in the case of employers. Therefore, no administrative problems are expected in these cases by holding the third parties liable for withholding taxes.

Third parties who specifically finance payrolls, although not paying employees directly, also are often in a position similar to that of employers. This appears to be true in those cases where they have actual notice or knowledge that the employers do not intend to, or are unable to, pay the amount of withholding taxes due the Government. Therefore, in these cases also it would appear practical for these third parties to account for the withholding taxes to the Government.

For the reasons indicated above, your committee has added a new provision to the law making lenders liable for the payment of withholding taxes in the type of cases referred to above.

(a) Liability where direct payments are made.-- Where a lender, surety, or other person directly pays wages to employees of another, the bill provides that he is to be personally liable for the withholding taxes, including not only income tax withholding, but also withholding for purposes of the social security and railroad retirement laws. The reference to 'other person' in this provision is intended to include anyone similar to a lender or surety who pays the wages of employees of another out of his own funds; it is not intended to include a person who is acting only as agent of the employer or as agent of the employees (such as a union agent).

This provision does not relieve an employer from his responsibilities with respect to withholding taxes. His responsibilities continue, even though a lender, etc., may be paying his employees' wages. The liability of the lender in such a case is to pay the taxes only where the employer does not ***3744** do so. Moreover, in any event, the employer is obligated to file an employer's tax return and comply with other requirements imposed on employers generally.

In those cases where a lender, etc., is required to pay to the Government withholding taxes, the Treasury Department is to provide appropriate schedules, forms, etc., where necessary, to assist him in determining the amount of his obligation. This is to include the supplying of information necessary for the Government to determine on what employee's behalf the payments are being made.

A lender, etc., who pays withholding taxes as a result of this provision (who is not the 'employer') is not liable for the employer's portion of payroll taxes.

(b) *Liability where a lender, etc., supplies funds to an employer for the purpose of paying wages.*-- The bill provides that if two conditions exist, a lender, etc., is to be personally liable for any unpaid withholding taxes even though he does not himself directly pay the wages of employees of the employer (the borrower). First, for this to be true, the lender, etc., must know that the funds he advances are to be used specifically for the payment of wages. This does not include an ordinary working capital loan even though the lender, etc., knows that part of the funds may be used to make wage payments in the ordinary course of business. Second, for this provision to apply, the supplier of the funds must have actual notice or knowledge that the employer does not intend to, or will not be able to, make timely payment or deposit of the withholding taxes. The burden of establishing actual notice or knowledge in such cases is on the Government.

The liability of the lender, etc., under this provision may not in any event exceed 25 percent of the amount he supplies the employer for the specific purpose of paying wages. Where a supplier of funds is liable for withholding taxes under this provision, his liability (with the exception of the fact that the amount involved is limited to 25 percent of the funds supplied) is the same as that of a lender who pays the wages directly. He also is subject to the same requirements as to the furnishing of information, etc.

(c) Effect of payment by lenders, etc.-- Under the bill, payments by the lender of withholding taxes reduces the liability of an employer. Similarly, payments by an employer of the withholding taxes reduces the liability of the lender, etc.

(2) Bonds on public works contracts (sec. 1 of the Miller Act; 49 Stat. 793)

In the cases discussed above, sureties can protect themselves against any losses attributable to withholding taxes by including this risk of liability in establishing their premiums, and lenders by their including the amounts in their loans and taking adequate security. Where they do so, losses now borne by the Government will fall (as it should) on the employers in the form of a larger bonding, or other fee or cost they must pay. Since the withholding taxes are, in true character, a part of the wages, it seems only appropriate that this cost be borne by the employers in the same manner as is true of the net wage costs. Because of this, your committee has concluded that, in the case of a contractor having a public works contract with the Federal Government, it is appropriate that the performance bond required by the Government specifically provide coverage ***3745** for the withholding taxes payable by the contractor in carrying out the contract. The bill amends the Miller Act to achieve this result.

Under the bill, a surety is obligated to pay the withholding taxes only if the Government gives him a written notice of the contractor's failure to pay the taxes. Separate notices are required for each taxable period. The Government must give the surety notice of a contractor's failure to pay the withholding taxes within 90 days after the contractor files his return, or, if the contractor fails to file this return, files it late, or obtains an extension of time for filing, the Government must in any event give the surety this notice within 180 days of the time the return was first required to be filed. In addition, the Government, if it is to bring suit for the failure on the part of the surety to pay the withholding taxes, must do so within 1 year of the time the notice is given to the surety of the unpaid tax liability.

F. SUSPENSION OF RUNNING OF PERIOD OF LIMITATION (SEC. 106 OF THE BILL AND SEC. 6503 OF THE CODE)

Generally, under present law, a tax may be collected by the levy procedure, previously discussed, or by a proceeding in court, at any time within 6 years after the assessment of the tax, or a longer period of time if agreed to by the Treasury Department and the taxpayer or by reason of suspending the running of the period. The running of this period of limitations on collections, however, under present law, is suspended where the assets of a taxpayer are in the custody or control of a court and for 6 months thereafter except in the case of an estate of a decedent or of an incompetent. Also the running of the period of limitations, under present law, is suspended for any period that collection is hindered because the assets of the taxpayer are out of the country. The bill modifies these two exceptions to the running of the statute of limitations. It also provides for the suspension of the period of limitations in another type of situation; namely, where the Government erroneously holds the property of a third person. These changes are discussed below.

(1) Assets of estate of a decedent or of an incompetent (sec. 6503(b) of the code)

As indicated above, the period of limitations is generally suspended where the assets of a taxpayer are in the control or the custody of a court; however, under present law, the statute continues to run in the case of the estate of a decedent or of an incompetent. The statute generally is suspended where assets are in the control or custody of a court because during this time they are not subject to administrative collection procedures. However, it appears that this reason applies equally well in the case of the estate of a decedent and in the case of an incompetent.

For the reason given above, the bill provides for the suspension of the running of the period of limitations on collections in the case of an estate of a decedent and an incompetent during the period their assets are in the control or the custody of a Federal or State court.

(2) Period taxpayers are outside the country (sec. 6503(c) of the code)

In addition to the staying of the period of limitations while the assets of a taxpayer are in control or the custody of a court, present law also provides for the suspension of this period of limitations where collection ***3746** of the tax is hindered or delayed because a taxpayer's property is outside of the United States.

This rule has been difficult to apply both because of problems in making the determination as to whether collection has been 'hindered or delayed ' because property is outside of the country and also because of the factual problem in knowing when property is outside of the country and for precisely how long.

To remove these problems, the bill provides for the suspension of the period of limitations during the period of the taxpayer's absence from the country rather than that of the property. It is believed that the collection of the tax is most likely to be hindered during the period of a taxpayer's abse[illegible]e. However, there are administrative problems in keeping track of short periods of time the taxpayer may be out of the country. The bill meets this problem by not suspending the running of the period of limitations except when the taxpayer is continuously out of the country for 6 months or more. To be sure that the Government has an opportunity to collect the tax after his return, it is provided that in any event, the period is not to expire (where the taxpayer has been out of the country for 6 months or more) until 6 months after the taxpayer's return to the country.

(3) Property of third persons wrongfully held by the Government (sec. 6503(g) of the code)

Under present law, the running of the period of limitations with respect to a taxpayer is not suspended where the Government erroneously holds the property of a third person. In a situation of this type the Treasury Department normally halts its collection procedures in the belief that the taxpayer's liability has been satisfied. On occasion where this has occurred, the taxpayer has waited until the period of limitations has run and then helped the third party recapture his property after the Government had no recourse, as far as the taxpayer was concerned.

Your committee believes that it is undesirable to encourage actions of the type described above. For that reason, the bill provides that the running of the period of limitations on collections is to be suspended during the period the Treasury Department holds property of a third person wrongfully seized or received, and for 30 days afterward.

The suspension of the period of limitations under this provision begins at the time of the wrongful seizure or receipt of the property by the Government. It ends 30 days after the Treasury Department determines the levy was wrongful and returns the property, or if the third party goes to court, it ends 30 days after the entry of a final judgment to the effect that the levy was wrongful.

Where the period of limitations is suspended under this provision, it is suspended only as to that part of an assessment equal to the amount of money or the value of specific property which initially has wrongfully been taken from a third party and subsequently is returned to him. This amount or value is to be determined as of the date of return.

*3747 G. PROCEEDINGS WHERE UNITED STATES HAS TITLE TO PROPERTY (SEC. 107 OF THE BILL AND SECS. 7402 AND 7403 OF THE CODE)

(1) Action to quiet title (sec. 7402(e) of the code)

Under present law, the United States has the right to acquire title to property through the enforcement of a Federal tax lien, but it is not clear, at the present time, that it has authority to bring action to quiet title to property which it has acquired through the enforcement of the tax lien. This uncertainty as to whether the Government has the right to bring action to quiet title hinders collection efforts since, unless the Government can give clear title to property, the marketability of property is severely limited, and the Government is likely to receive substantially less than the true value of the property in any subsequent sale.

For the reasons indicated above, your committee's bill gives the Government express authority to bring an action to quiet title to property it has acquired through the enforcement of a tax lien. Jurisdiction in cases of this type is given to the Federal district courts.

(2) Sale bids (sec. 7403(c) of the code)

Where property is sold at a tax lien foreclosure sale, the Internal Revenue Code contains no specific authority authorizing the Federal Government to bid at these sales where it believes that less than full consideration is being offered for the property. Such authority is contained elsewhere, however, in the public statutes (see sec. 195 of title 31 of the United States Code).

It is desirable for the Federal Government to bid in property to prevent its sale at distress prices in order to assure that the Government receives the full value of the property sold or the amount of the Government's tax claim, as well as to protect the interests of the delinquent taxpayer whose property is being sold.

For the reason indicated above, the bill codifies the rule that where the Government brings an action to enforce a tax lien, the Government can bid on the property where the Government holds a first lien. The amount which it may bid under the bill is limited to the amount of its lien, plus selling expenses. Whether or not the Government exercises this authority to bid within the limit set forth in the bill is a matter within the discretion of the Treasury Department.

H. INTERVENTION BY UNITED STATES (SEC. 108 OF THE BILL AND SEC. 7424 OF THE CODE)

Under present law, some questions have arisen as to whether the Government can intervene in a court proceeding to assert a tax lien against property. The Government is not expressly authorized to do so, and the opinions of the courts which have considered the issue are divided.

The absence of express authority for the Government to intervene to assert a tax lien has resulted in the Government attempting to achieve the same result by other means, such as by bringing a separate action to assert its lien.

The bill grants the Government authority to intervene in a court proceeding to assert a tax lien against property to avoid the result described***3748** above. In these cases where the Government intervenes, the same procedural rules, to the extent applicable, are to apply as where the Government is initially joined properly as a party. Where the Government's application to intervene is denied, the proceedings are to have no effect on the Government's tax lien on the property. This is consistent with the results which follow where the Government is not joined as a party.

I. DISCHARGE OF LIENS HELD BY UNITED STATES (SEC. 109 OF THE BILL AND SEC. 7425 OF THE CODE)

Under present law, a junior Federal tax lien may be discharged on foreclosure of a senior security interest. Such foreclosure may occur in a plenary judicial action, or, under the law of some States, by nonjudicial foreclosure pursuant to a power of sale contained in the senior security instrument. In addition, in in some States, foreclosure of a senior security interest may be accomplished by sale of the property by a judicial officer pursuant to a judgment entered under a 'confession of judgment' signed by the debtor (typically in the security interest instrument itself). Where State law so provides, a junior Federal tax lien may be extinguished without the United States either being made a party to the proceeding or having any actual notice. As a result, under current law tax liens are sometimes extinguished without the United States having actual notice of the proceedings, under circumstances where it is not possible for the Internal Revenue Service to take steps to protect the United States in the collection of its tax revenues.

Where there is a plenary judicial proceeding and the Government, as a junior lienor, must be joined for its interests to be discharged in the proceeding, the present procedure works will. However, in other cases where the interests of junior lienors may be eliminated without notice, it appears that the interests of the Government are not presently sufficiently protected. Although legitimate local considerations may preclude requiring the Government (in other than plenary proceeding) to be joined as a party for its interests under a tax lien to be discharged, there does not appear to be any reason why in these cases there should not be a timely notice of the proceedings to the Government where notice of its tax lien is on file. The requirement of notice gives the Government an opportunity to review its position and determine the appropriate action without placing an undue burden on a foreclosing creditor.

As explained below, the bill adds a new provision to the internal revenue laws requiring the Government to be made a party in a plenary proceeding to discharge a tax lien. The bill also makes provision for a timely notice to the Government where it has the status of a junior lienor and there is no plenary proceeding.

(1) Plenary foreclosure actions (sec. 7425(a) of the code)

The bill provides that in a plenary judicial proceeding where the Government has properly filed notice of a tax lien before the proceedings commence, but the Government is not joined as a party in the court proceeding, a judgment as to the property is not to disturb a tax lien or claim of a tax lien of the Government on this property. The same ***3749** result is to occur when the property is sold pursuant to the judgment; the lien on the property continues into the hands of the third person. Where the Government is joined in these proceedings no change is made by the bill in the present operation of local law.

Where a notice of tax lien is not filed before a plenary proceeding commences-- even in those cases where the filing is not required, such as in the case of a special lien for estate and gift taxes-- a judicial sale is to have the same effect with respect to a tax lien as local law provides with respect to such matters. One exception is provided to this rule: where the Government is not joined as a party and the sale discharges the tax lien, the Government may still assert its claim against the proceeds of the sale at any time before their distribution is ordered with the same force as the lien had against the property sold.

(2) Other foreclosure proceedings (sec. 7425(b) of the code)

The bill provides that, in the case of all other foreclosure proceedings, where timely notice of the proceedings is given to the Government, the Government's claim to property under a tax lien is to be discharged in the manner provided by local law.

Where foreclosures covered by this provision are made without proper notice to the Government, the bill provides that this does not affect the Government's claim under a tax lien (as where the Government is not joined in a judicial foreclosure). In these cases, the Government's claim continues against the property into the hands of a third party. On the other hand, where notice of the Government's claim under a tax lien is not filed (even in those cases where filing is not required), or where the Government is notified of the proceeding, a sale has the same effect on the claim as local law provides with respect to similar claims. (This is the same result as where the Government is not joined as a party in a plenary proceeding where its lien is not on file.)

(3) Special rules (sec. 7425(c) of the code)

In connection with the plenary and other foreclosure proceedings outlined above, the bill provides a series of rules which are to be followed. For the most part these concern procedural matters. These can be summarized as follows:

(a) Under the bill for a notice of sale to be effective, it must be delivered to the Treasury Department at least 25 days prior to the sale.

(b) As previously indicated under the bill, the Government has the discretion to consent to a sale, free of its claim.

(c) Under the bill, where property is perishable, the 25-day notice rule referred to in (a) above is waived and the property may be sold free of the Government's claim as long as notice is given the Government at any time prior to the sale.

Where perishable items are sold, under this provision, the proceeds of the sale must be held subject to the claim of the Government for 30 days and the Government's claim to these proceeds is the same as its claim to the items sold. Should the seller fail to hold the proceeds for the 30-day period, he is to be personally liable to the Government for its claim, where the Government asserts its claim during the 30-

day period, to the extent of the next amount of the proceeds.

***3750** (4) Redemption by the United States (sec. 7425(d) of the code)

As previously indicated, under the bill the Government is given the authority to redeem real property sold under other than plenary judicial proceedings where the sales were to satisfy a lien prior to a tax lien. The period of time for redemption in these cases is 120 days from the date of sale or the period allowable under local law, if longer. Where the Government exercises its right of redemption, it must pay the amount paid by the purchaser at the sale plus interest and expenses necessary to maintain the property from the time of sale. Procedures are set forth to be followed in preparing certificates of redemption for this purpose.

J. CIVIL ACTIONS BY PERSONS OTHER THAN TAXPAYERS (SEC. 110 OF THE BILL AND SECS. 7426, 6532 AND 7421 OF THE CODE)

Present law is quite limited in the extent to which it takes into account the rights of third parties in the procedures set out in the tax laws for the collection of taxes from a taxpayer. Under present law, for example, the United States cannot be sued by third persons where its collection activities interfere with their property rights. This includes cases where the Government wrongfully levies on one person's property in attempting to collect from a taxpayer. However, some courts allow suits to be brought against district directors of Internal Revenue where this occurs. Technically, these suits are not against the Government but, in fact, the Government defends them and pays all costs, so that the effect is practically the same as if these suits were brought against the United States.

Another area in which present law does not adequately take into account rights of third parties are cases where the Government levies on a taxpayer's property and sells it for more than the taxes he owes. In these cases the taxpayer can bring a refund action against the Government for the surplus, but a third person who has a junior lien on a taxpayer's property (entitling him to part or all of these surplus proceeds) presently cannot sue to claim them. As a result, where the Treasury Department denies his claim to these proceeds, he is without a remedy against the Government.

Still another area exists where present law is relatively restrictive in dealings by the Government with third parties. There is no provision in present law authorizing the Treasury Department to enter into agreements with taxpayers and third persons allowing property subject to a tax lien to be sold free of the lien pending a determination of who is entitled to the proceeds.

Your committee believes where the Government levies on property which, in part at least, a third person considers to be his, he is entitled to have his case heard in court. While, under present law, some courts in effect permit this result by allowing suits to be brought against district cirectors, your committee believes this result should be generalized. In addition, your committee believes it is more appropriate, instead of bringing the actions against district directors, to bring them directly against the Government. Your committee also believes that a person who claims an interest in surplus proceeds realized by the Government when it sells property to satisfy a tax liability is entitled to judicial consideration of his claim if it is denied ***3751** by the Treasury Department. Once a taxpayer's liability is satisfied, the Government's retention of surplus proceeds is wrongful as to the person legally entitled to them. In addition, since this bill authorizes the Treasury Department to enter into agreements with taxpayers and others to sell property pending a determination of who is entitled to it, your committee believes that claimants to the property should be permitted to join the Government in an action where they are unable to resolve this matter.

For the reasons given above, your committee's bill permits wrongful levy actions and actions for surplus proceeds to be brought against the Government by nontaxpayers. Similarly, it allows anyone, including taxpayers, to bring an action for the distribution of substituted sale proceeds. These are all actions in which the taxpayer's tax liability is not open to question.

(1) Actions permitted (sec. 7426(a) of the code)

The bill makes provisions for three new types of actions all of which may be brought only in Federal district courts. First, where a person claims the Government wrongfully levied upon his property to satisfy the tax liability of another, the bill provides that he may bring suit against the Government. 'Wrongful,' as used here, refers to a proceeding against property which is not the taxpayer's. A person may bring suit under this provision once a levy is made.

Second, where a person (other than the taxpayer) claiming a junior interest in property also claims he is entitled to the surplus proceeds the Government realized on a sale of the property following a levy, the bill provides he may bring suit against the Government. 'Surplus proceeds' are those in excess of the amount necessary to satisfy the tax liability giving rise to the levy and the expenses of the levy sale.

Third, where a person claims he is entitled to the proceeds of property once subject to a tax lien which is sold, under an agreement with the Government, to hold the proceeds instead of the property, the bill provides that he may join the Government to assert his claim to these proceeds. Any person, including the taxpayer, may bring suit under this provision, although, of course, for purposes of a suit under this provision, too, the assessment against the taxpayer is conclusively presumed valid.

(2) Forms of relief (sec. 7426(b) of the code)

Where a person brings a wrongful levy action, or an action claiming an interest in either surplus proceeds or substituted sale proceeds, the relief the

Federal district court can grant is limited to one of the four types described below.

First, the bill provides that a court can enjoin the Government from proceeding once it has levied, where it determines that a seizure or surrender of property under a levy, or a sale of property following a levy, makes injunctive relief appropriate. Injunctive relief is limited to cases where the court determines the Government's action is wrongful and, if completed, would irreparably injure the rights of another in the property which are prior to the rights of the Government. If this issue is decided in the person's favor, typically the injunction is either made permanent, where the Government does not have possession of the property, or is continued until the levy is released and the specific property is returned to the person.

***3752** Second, where a court determines the Government's levy is wrongful, the bill provides that the court can order the Government to return the specific property levied on or award the person who brings the action a money judgment. Any relief under this provision is conditioned on a finding that the property levied on did not belong to the taxpayer. The bill provides that a court can order the Government to return property wrongfully levied on only where it is identifiable and still in the Government's possession. (Property under this provision includes money where identifiable, such as a coin collection.) Where the Government wrongfully levies on money, relief under this provision is limited to the amount of the money, and where the Government wrongfully levies on other property which is no longer in its possession, relief is limited to the amount the Government received from its sale. Where the Government was the purchaser of the property at the sale, this amount received from the sale is to be the minimum price at which the Government would have allowed the property to be sold, or, if more, the amount received by the Government when it later resold the property.

Third, where a court determines that the claim of a person is transferred from property to surplus proceeds remaining after the levy sale by the Government, the court can award the party (or parties) a judgment (or judgments) in an amount not in excess of the surplus proceeds the Government realized on the enforcement of its levy.

Fourth, where a court determines that a person's claim to property sold under an agreement providing for the proceeds to be substituted in their stead is valid, the bill provides that the court can award the person (or persons) a judgment (or judgements) in an amount not in excess of the substituted sale proceeds.

K. SALE OF PROPERTY ACQUIRED BY UNITED STATES (SEC. 111 OF THE BILL AND SECS. 7505(a) AND 7506(a) OF THE CODE)

Under present law the Government has express authority to sell personal property purchased by it at a sale following a levy. It does not have, however, express authority to sell personal property acquired by other means in the administration of the tax laws. Similarly, although the Government has express authority to administer and sell real property acquired by it under various procedures in the administration of the tax laws, it does not have express authority to administer and sell real property acquired by it under various procedures in the administration of the tax laws, it does not have express authority to administer and sell real property acquired by it by redemption.

Where the Government has acquired property as the result of redemption and other procedures under the tax laws, in practice it has had to administer it and, subsequently, to sell the property. Your committee believes it is appropriate for express authority for these actions to be contained in the revenue laws. This is particularly desirable for the future because with the redemption fund (see next provision) set up by the bill, the redemption procedure probably will be used more often in subsequent years.

***3753** For the reasons given above, your committee's bill amends existing law to make it clear that the Government's authority to administer and sell property it acquires in the administration of the tax laws extends to property acquired by redemption and other means.

L. FUND FOR REDEMPTION OF REAL PROPERTY BY UNITED STATES (SEC. 112 OF THE BILL AND SECS. 7809(a) AND 7810 OF THE CODE)

Under present law the Government can redeem real property on which it has a junior lien where the property is sold at a foreclosure sale brought by a holder of a senior lien. The bill extends somewhat the authority the Government has to redeem real property in certain cases where it is sold at foreclosures not involving plenary judicial proceedings. No fund for the purchase of redeemed property is authorized, however, and some question exists as to whether general appropriations can appropriately be used for this purpose.

By exercising its power of redemption the Government can purchase property sold at distress prices and resell the property at a profit. This profit, of course, is applied in satisfaction of the taxpayer's liability. In some instances this procedure is the only means by which the Government can collect taxes due. In all instances, however, the exercise of this power, where redeemed property is sold at a profit, inures to the benefit of delinquent taxpayers.

In view of these considerations, your committee believes the Government should exercise its power of redemption, and for this reason the bill establishes a separate revolving fund out of which funds can be drawn for this purpose. It is anticipated that the proceeds on the resale of redeemed property will replenish the revolving fund so that additional appropriations will not be necessary.

The bill provides for the establishment of a revolving fund out of which the Government can draw funds to redeem real property. This fund is to be subject to the control of the Treasury Department and is without fiscal year limitation. The total authorization for the fund is $1 million. When redeemed property is resold, the proceeds of the resale, to the extent of the costs of redemption, are to be deposited in the fund. The remaining proceeds are, of course, applied in satisfaction of the taxpayer's *liability. Any surplus is returned to the parties legally* entitled to them.

M. EFFECT OF JUDGMENT ON TAX LIEN AND LEVY (SEC. 113 OF THE BILL AND SECS. 6322 AND 6502(a) OF THE CODE)

Under present law, it is not clear whether a lien arising from a tax assessment continues where the liability underlying the lien is reduced to judgment. One effect, if the lien does not continue where it is reduced to judgment, may be that the Government loses its priority under the lien, vis-a-vis competing creditors, and takes a new priority as of the later date of the judgment. Another effect, if the lien does not continue after the judgment, may be that the Government cannot enforce the tax lien and collect under it, but must pursue collection under the judgment. There is also some question under present law of whether the entry of a judgment ***3754** cuts off the Government's right to collect by levy, even though the normal 6-year period of collection on the tax assessment has not expired at the time the judgment is entered.

Your committee believes the entry of a judgment confirming an assessed tax liability should not cut back on the rights of the Government. Both the judgment and the lien arise out of the same tax liability, and it is intended that this liability continue until it is satisfied or becomes unenforceable by reason of lapse of time. Since the liability giving rise to the lien and that giving rise to the judgment is the same, your committee believes the Government's priority, *vis-a-vis* other creditors, should be the same under each. Moreover, since, in effect, the judgment merely confirms the validity of the lien arising out of the tax assessment, it is believed that the Governments' right to foreclosure under the tax lien (as contrasted to the more cumbersome method of foreclosing under the judgment) should not be curtailed as the result of reducing the assessment to judgment. Your committee recognizes, however, there comes a time when it is inappropriate for the Government to collect by administrative levy action without court supervision.

For the reasons indicated above, your committee's bill amends existing law to provide that a tax lien is not merged into a judgment on the assessed tax liability. Under the bill, where a tax assessment is reduced to judgment, the lien continues until the underlying tax liability is satisfied or becomes unenforceable by reason of lapse of time. The bill also makes it clear that the Government's right to collect taxes due by administrative levy action is neither curtailed nor expanded by the judgment.

N. CONSENT OF UNITED STATES TO BE JOINED IN CERTAIN PROCEEDINGS (SEC. 201 OF THE BILL AND SECS. 2140(a), (b), (c), AND (d) OF TITLE 28)

This section relates to judicial proceedings affecting property on which the United States has or claims a mortgage or other lien. Under present law the Government may be brought into a judicial proceeding as a party to quiet title to property or to foreclose a mortgage or other lien on property; it may not, however, be joined as a party in certain other judicial proceedings. The result is that where parties attempt to join the Government in cases other than the type previously described, the Government must move to dismiss the motion to join and, where it wants to assert its interest, it must petition to intervene or initiate a new proceeding.

Present law sets forth the pleading requirements for those actions where the Government may be joined as a party. This is to the Government will have notice of the reason it is being joined. Similarly, the statute spells out under what circumstances the relief granted to private parties in actions where the Government is joined is to affect the Government's interest. Thus, where a judicial sale is ordered in the proceedings, it is specified that the sale is to have the same effect on the Government's interest as local law provides with respect to similar matters. The statute also gives the Government the right to redeem the property sold at the sale for reasons previously discussed in this report. It does not, however, contain rules for determining the redemption price.

Your committee believes the Government's consent to being joined as a party should be broadened to include those cases where experience has ***3755** shown it is desirable for the Government to be a party in order to assert its interest. This also requires changing the present pleading requirements to be sure the Government will be informed of the reasons for its being joined in these actions. Similarly, in these new actions, a judicial sale may not always be the appropriate remedy. Experience has also shown that in order to obtain uniformity a rule for determining the amount the Government must pay where it exercises the right of redemption needs to be provided.

In accord with the reasons given above, the Government's consent to be sued is broadened to include 'partition' and 'condemnation' suits and 'interpleader ' suits and suits 'in the nature of interpleader.' Partition suits are those where persons with undivided interests in a parcel of property seek to have their undivided interests in the whole divided into separate interests in portions of the parcel. Condemnation suits are those brought by governmental (and quasi-governmental) units to acquire private property for the purpose of converting it to public use. Interpleader actions are those brought by persons holding property for the purpose of determining who is entitled to the property held.

The bill also makes two changes in present law with respect to the pleading requirements in those actions where the Government has consented to be joined as a party. The first change makes it clear that any pleading which attempts to join the Government as a party must refer to the Government's interest in the suit. Under present law the statute provides that only the complaint must refer to the Government's interest. The second change specifies the type of information (such as the name of the taxpayer whose tax liability gives rise to the Government's interest in the action, the district director's office involved, etc.) which must be contained in the pleading seeking to join the Government in actions involving liens under the internal revenue laws.

The bill provides that, generally, in suits where the Government is joined as a party, the judgment of the court is to have the same effect with respect to the discharge of the Government's interest as applicable local law provides with respect to similar matters. An exception is made where a sale is ordered to satisfy a lien junior to the Government; here, the Government's interest cannot be discharged without its consent, even if local law provides otherwise.

Under this provision, in the new types of suits in which the Government has consented to be sued, and in a quiet title action as well, the person bringing the suit does not have to request a judicial sale for the judgment of the court to have the effect of discharging the property from the Government's interest where local law so provides. In an action to foreclose a mortgage or other lien, on the other hand, the person must seek a judicial sale.

Changes are also made regarding the Government's rights where property is sold in actions where the Government is joined. First, where the lien arises under the internal revenue laws, the provision cuts the period in which the Government may redeem the property from 1 year to 120 days or, if longer, the period allowed by applicable local law. This gives the Government a sufficient time to determine whether redemption is desirable. The second change the bill makes here is to add to the judicial code the exceptions to the right of redemption presently contained in separate Federal ***3756** acts (such as the Housing Act of 1950). The last change the provision makes is that it authorizes the head of a department to delegate his authority to bid on property sold at one of these proceedings to satisfy a prior lien of the Government.

The bill also provides a formula for determining the price the Government must pay where it redeems property sold in proceedings where the Government is joined as a party (under this section), and where it is sold in foreclosures other than plenary judicial proceedings. The redemption price is to be the amount paid by the purchaser at the foreclosure sale plus interest at the statutory rate (6 percent) from the date of sale. Where the purchaser at the sale is the person whose lien is being foreclosed, the amount paid by him includes the amount of the debt underlying his lien to the extent that the lien is satisfied by the sale. Where the lien is fully satisfied, the purchaser is not to receive less than the amount due him at the time of sale. Where the lien attaches to other property, however, or where, after the sale, the purchaser still has the right to sue for the unpaid balance of the amount due him, the amount paid does not include this unpaid balance.

In addition to the price by the purchaser plus interest, in order to redeem property, the Government must pay, as part of the redemption price, the excess, if there is any, of any expenses incurred after the foreclosure sale in maintaining the property over the income from the property during this period. Where the property is not rented out but is used by the purchaser, the income includes the reasonable rental value of the property.

O. JURISDICTION AND VENUE IN CERTAIN CASES AGAINST UNITED STATES (SEC. 202 OF THE BILL AND SECS. 1346(e) AND 1402(c) OF TITLE 28)

Under present law, the Government cannot be sued where it wrongfully levies upon property, or in actions involving surplus proceeds or substituted sale proceeds. Therefore, present law contains no provision giving the Federal courts jurisdiction over actions of this type. Similarly, there are no venue provisions determining in what judicial district these actions may be brought.

Since under other provisions of this bill wrongful levy actions, and actions involving surplus proceeds and substituted sale proceeds, may be brought, courts must have jurisdiction over them and venue rules must be provided.

Your committee's bill, therefore, confers jurisdiction on the Federal courts over wrongful levy actions, and actions involving surplus proceeds and substituted sale proceeds. The Federal district courts have original jurisdiction over these actions.

As to venue, the bill provides that wrongful levy actions, and actions involving surplus proceeds and substituted sale proceeds, are to be brought only in the judicial district where the property levied on is situated at the time of levy. Where the action does not arise out of a wrongful levy (such as in certain cases involving substituted sale agreements) the action is to be brought where the event giving rise to the lawsuit occurred.

P. EFFECTIVE DATE (SECS. 114 AND 203 OF THE BILL)

The bill provides, as a general rule, that the amendments made by the bill are to apply after the date of enactment. This is true regardless of when ***3757** a lien or a title of the United States arose or when a lien or interest of any other person was acquired. However, the bill provides certain exceptions to this general rule as to the effective date for the provisions of the bill. They are as follows:

(1) The amendments made by the bill are not to apply in any case where the Government has, in effect, completed enforcement of its interest arising under a lien. Thus, the amendments are not to apply where the enforcement proceeding has reached the stage of a civil action or suit which has become final by judgment, sale, or agreement, before the date of enactment.

(2) The amendments are not to apply to any case where they would impair a priority of any person holding a lien or interest prior to the date of enactment; increase the liability of any person; or, shorten the time for bringing suit with respect to any transaction occurring before the date of enactment.

(3) The amendments imposing a liability on third persons who pay wages of the employees of another, are to apply only with respect to wages paid on or after January 1, 1967.

(4) The amendment requiring performance bonds on public works contracts to provide for the payment of withholding are to apply only to contracts entered into pursuant to invitations for bids made by the Government after June 30, 1967.

(5) Where a person has commenced a civil action to clear title to property under the present law (sec. 7424 which, in effect, is repealed by the this bill), the action is to be determined in accordance with that section without regard to this bill.

FN1 See Uniform Commercial Code, sec. 9-310, regarding mechanic's lienors. Compare the definition of 'security interest' in Uniform Commercial Code, sec. 1-201(37).

FN2 In some cases involving tangible personal property, this was because the physical location of the property was elsewhere. In other cases, involving intangible personal property, this was because the residence of the competing claimant (such as an insurer which made a policy loan) was elsewhere.

FN3 As to what constitutes 'property,' it is intended that what becomes a part of realty is to be determined by local law.

FN4 This is intended to include money previously parted with if, under local law, past consideration is sufficient to support an agreement giving rise to a security interest.

(Note: 1. PORTIONS OF THE SENATE, HOUSE AND CONFERENCE REPORTS, WHICH ARE DUPLICATIVE OR ARE DEEMED TO BE UNNECESSARY TO THE INTERPRETATION OF THE LAWS, ARE OMITTED. OMITTED MATERIAL IS INDICATED BY FIVE ASTERISKS: *****.

2. TO RETRIEVE REPORTS ON A PUBLIC LAW, RUN A TOPIC FIELD SEARCH USING THE PUBLIC LAW NUMBER, e.g., TO(99-495))

S. REP. 89-1708, S. Rep. No. 1708, 89TH Cong., 2ND Sess. 1966, 1966 U.S.C.C.A.N. 3722, 1966 WL 4161 (Leg.Hist.)